# The Budget 1993



*Tabled in the House of Commons*
*by the Honourable Don Mazankowski*
*Minister of Finance*

*April 26, 1993*

Canada

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Department of Finance Canada    Ministère des Finances Canada

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# Chapter 1: Charting the Course for Growth

Today I am presenting a budget that will deliver:

- no new taxes;
- no tax increases;
- more than $30 billion in spending cuts and other measures;
- zero real growth in federal spending on programs and services;
- the lowest federal program spending as a share of the economy in more than 30 years;
- the elimination of all new federal borrowing within five years; and
- a strong, positive initiative for a co-operative national attack on all government debt.

***Cutting spending to cut borrowing . . .***

The goal of this budget is to free the economy for more job creating growth by steadily reducing the burden of deficits and debt.

Today I will outline a process to bring federal and provincial governments together to work toward that goal.

***. . . to free the economy for growth and jobs***

There is only one taxpayer. Canadians want a national solution to the national debt problem, and they want their governments to act now.

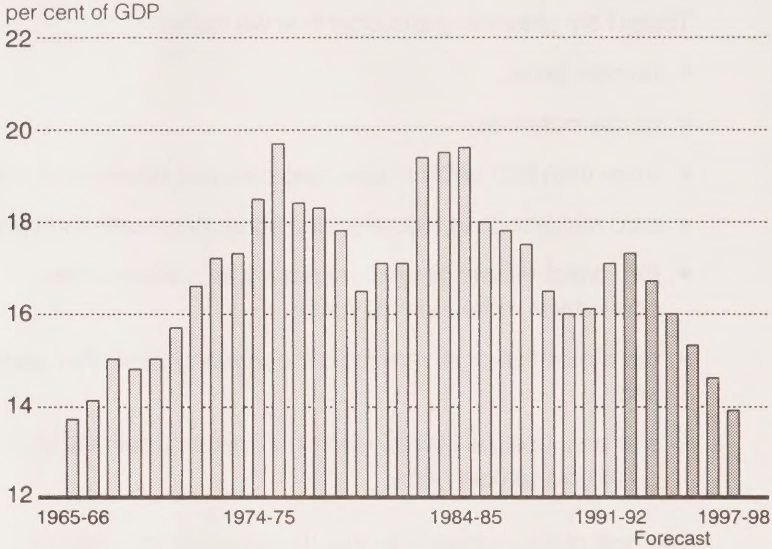
This budget sets out a responsible, achievable course of action:

- It builds upon the actions in previous federal budgets, but recognizes that a problem that began two decades ago will not disappear overnight.
- It also underlines that by working together as governments and as Canadians, we can make an immediate and fundamental change for the better in the prospects for our economy, our country and our people.

***National problem, national solution***

This budget is presented at a time of unprecedented public concern about the collective spending and borrowing habits of our governments.

**Chart 1**
*Lowest program spending as a share of the economy in more than 30 years*




Canadians are justified in their concerns. They know that a household can't keep running up credit card bills and borrowing to pay interest. And they have seen what happens when governments act as if they are exempt from the same basic rules of common sense. This is what happens:

- Taxpayers pay more and more for less and less service from government because interest eats up a growing share of the tax dollar. And those higher taxes act as a brake on the economy. Less economic activity means less growth and fewer jobs.
- Homeowners pay higher mortgage rates because government borrowing drives up the price of money. Higher interest rates discourage investors and consumers, and that too means less growth and fewer jobs.
- Finally, in an effort to maintain a standard of living that we no longer earn, we rely more and more on foreign lenders. This leaves Canada with less and less control of its own economic future. And the income we do earn goes increasingly to pay interest to foreigners.

Canadians want to keep control of their future. They want their governments to have the means to maintain vital social support services and the flexibility to respond to emerging priorities.

***Less borrowing, lower taxes . . .***

Less borrowing, lower taxes, more jobs and more choice: that is the direction in which people want to go. And that is the direction in which this government is going.

***. . . more jobs, more choice***

## Fiscally responsible actions for growth and competitiveness

This government has been and is fully committed to helping Canadians build a stronger economy that creates jobs and that can adapt, compete and prosper in the new, more competitive and rapidly changing global economy.

That is why we have continued to move forward on policies such as:

- bold trade initiatives to secure and expand access to markets;
- innovative job training measures to help Canadians adapt to a changing workplace;
- tax reforms to increase incentives for work, investment and prosperity; and
- regulatory reform and privatization to reduce government and improve efficiency.

***Helping to build a stronger economy . . .***

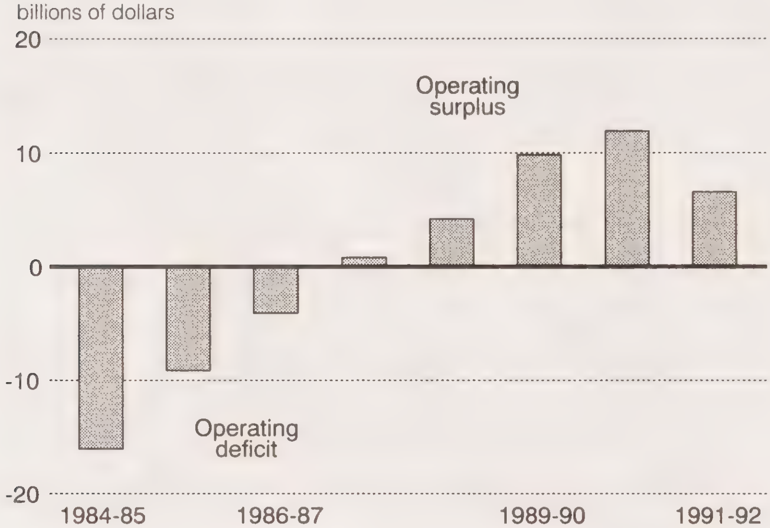
Most of all, we must and will continue with our firm, responsible spending control policies. Since 1984-85, we have made real progress in a changing, uncertain world economy.

- We have cut the average annual growth of federal program spending from 13.8 to 4.1 per cent.
- We have cut the federal deficit from 8.7 to 5.1 per cent as a proportion of our national income.
- We have turned an operating deficit into an operating surplus. This means the government now spends less on programs and services than it raises in revenues – and has done so for the last six years.

***. . . through firm spending control***

**Chart 2**

*A marked turnaround in the operating balance after 1984-85*




Over the past few years, a persistent and painful global economic slowdown has repeatedly forced governments, businesses and households in Canada and around the world to adjust their plans for the future. This has hastened the basic restructuring of our economy in response to global economic change.

To help Canadians cope with the economic downturn and adapt to global competition, we took firm action in the February 1992 budget and the December statement.

***Targeted action for growth and jobs . . .***

- We cut personal income taxes; we enriched and restructured the child benefit system to help families with low or moderate incomes. This is injecting $1.7 billion into the economy this year alone.
- We introduced the Home Buyers' Plan to help Canadians buy or build homes using funds from their RRSPs. More than $1.4 billion of these funds have been invested in homes by 148,000 Canadians.
- We increased our already substantial support for small businesses, the prime source of new job creation in Canada. And they are now creating jobs.

- We substantially improved access for small business to financing by overhauling the *Small Business Loans Act.* Indications are that banks will lend more than an additional billion dollars to small businesses this year.
- We increased to $3.8 billion our investment in Canada's most important resource – the knowledge and skills of its people. This will benefit more than one million Canadians this year alone.
- We announced major new strategic capital investments in Canada's national transportation and communications networks. A start is now being made on infrastructure projects creating 15,000 person-years of employment, with an additional 15,000 to come from further projects to be announced in the weeks and months ahead.
- We provided tax relief for manufacturers. Since August, manufacturing shipments have grown at an annual rate of almost 15 per cent. In February, unfilled orders increased 5 per cent, the largest increase in almost five years.

The measures that I have referred to are being funded out of savings from last year's budget and the December statement. Our measures have been implemented and they are working. The bottom line is jobs – 200,000 full-time jobs created since August.

In December, following on the Prosperity initiative, we set aside an additional $400 million over five years for further tax changes in three areas important to economic growth and job creation.

***Investing in prosperity***

- Today I am proposing tax changes to improve the treatment of rapidly depreciating new equipment; strengthen the ability of Canadian firms to access new technologies; and improve the effectiveness of incentives, particularly for small innovative companies. Details of this initiative are contained in the supplementary information which I will be tabling.

In response to representations on the equity capital needs of smaller, knowledge-based firms, we will also explore ways to develop mechanisms to encourage investors to support local companies and at the same time lend their expertise to help the companies succeed.

In 1992, we broadened and deepened the Expenditure Control Plan introduced in the 1990 budget. We did not increase taxes for Canadians.

- We cut departmental operating budgets.
- We cut Cabinet ministers' salaries and froze salaries for MPs and all public servants.
- We reduced grants and subsidies to most organizations by 10 per cent.
- We streamlined government by eliminating or restructuring agencies, commissions and boards.
- We took action to control unemployment insurance costs.

***1992-93 program spending on target . . .***

And we have delivered. Program spending in 1992-93 is on target with the December forecast – and $500 million below the target in last year's budget.

During 1992, the world economy grew more slowly than expected. The result for Canada was lower-than-expected growth, lower revenues and higher deficits. For 1992-93, revenues were more than $9 billion lower than forecast in February 1992. A shortfall in that range is likely to continue over the next five years.

***. . . but revenues lower***

Regrettably, lower-than-expected revenues have brought the deficit for 1992-93 to $35.5 billion, $1.1 billion higher than forecast in December. I am disappointed by this setback. We have, however, taken corrective action to keep the 1993-94 deficit on target at $32.6 billion and we are tackling the medium-term deficit challenge with aggressive new action.

## ■ *Meeting the challenge of deficits and debt*

This budget sets out a five-year plan to eliminate new borrowing by further cutting back spending and by making government leaner and more efficient.

*Zero real growth in program spending . . .*

The key to the plan is this: Federal government program expenditures will be held to zero real growth – no greater than inflation.

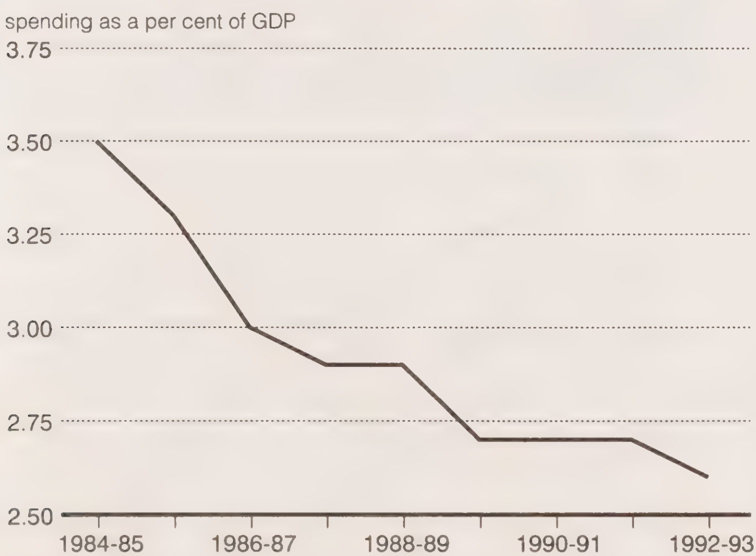
The measures in the budget extend and reinforce the actions in the December statement. They will yield combined savings of $3.8 billion in 1993-94, rising to $7.9 billion in 1997-98. All told, these measures will save $30.7 billion.

*. . . and no increase in taxes*

I want to emphasize again that there are no tax increases in this budget. There are only two ways to reduce the deficit – higher revenues and lower spending. The right way to get the deficit down is by cutting spending. The right way to get revenues up is to encourage more economic growth, and you can't do that by raising taxes.

The first priority in reducing spending is to cut the operating costs of government. Since 1984-85, these costs have been tightly and repeatedly restrained. As a result, operating costs declined from about 22.5 per cent of total program spending in 1984-85 to just under 15 per cent in 1991-92. The real cost of delivering programs has been cut by 14 per cent.

**Chart 3**
*Operating expenditures were reduced as a share of GDP*



***Costs of government operations cut***

To further reduce the cost of government, I am announcing the following actions:

- Departmental operating budgets, including reserves for contingencies and new initiatives, will be cut by an additional $300 million in both 1993-94 and 1994-95, rising to $1.2 billion in 1997-98. Including the wage freeze and operating budget reductions in the December statement, the reduction by 1997-98 will amount to 10 per cent. Total savings will be $7.5 billion over five years.

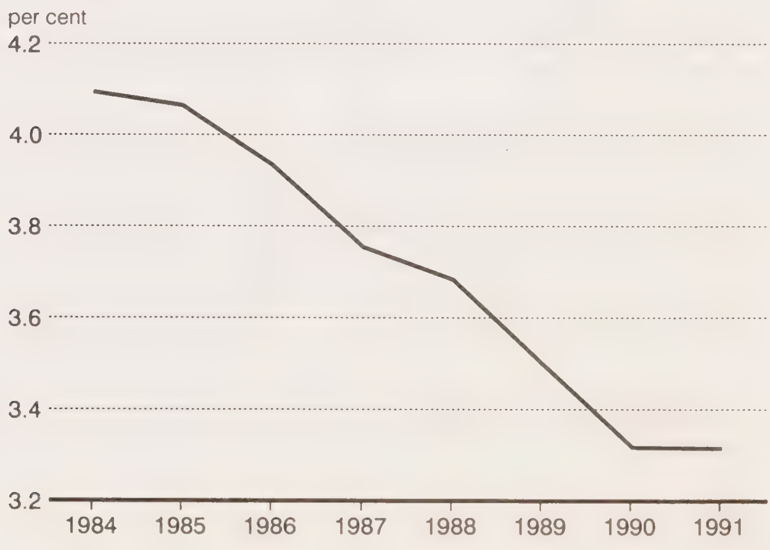
  These are significant cuts. They will force increases in productivity but will also result in reduced service levels and the closure of offices and points of service. To improve efficiency while cutting costs, the federal government will have to employ fewer people.

***Wide range of programs reduced, restrained . . .***

- Defence spending will be frozen in real terms beginning in 1994-95. Together with the actions taken in December, this will generate savings of $361 million in 1993-94, rising to $2 billion in 1997-98 and totalling $5.9 billion over the five-year period.
- Funding for the Research Councils will be held to 1.5 per cent annual growth after 1994-95.

**Chart 4**

*Federal employment was reduced significantly as a share of the total Canadian work force*



- The same constraint of 1.5 per cent annual growth will be placed on government spending on international assistance. Canada's efforts in this area will continue to compare favourably with those of the major industrial countries.

- Most of the grants and contributions already reduced by 10 per cent this year and next will be reduced by 15 per cent in 1995-96 and 20 per cent thereafter. This measure underlines the need for greater self-reliance on the part of advocacy groups and other private sector organizations.

- We must also ensure that we obtain maximum value for the money we spend by reducing economic distortions and ensuring that we meet the global competitive challenge. Working closely with the affected parties, the government has begun a process of reform in the area of western grain transportation; and it intends to pursue reform in the application of Atlantic freight subsidies and in the dairy industry. To facilitate reform, the government is prepared to direct back to these sectors savings from the deepening of the cuts in grants and contributions.

- In the December 1992 statement, funding for regional development was reduced by 10 per cent for both 1993-94 and 1994-95. This reduction is now being extended. In addition, regional development funding will be reduced by a further $90 million in 1993-94, rising to $100 million per year beginning in 1994-95. Over time there will be a shift from grants to repayable contributions. This will provide a pool of funds for new regional development projects and reduce the need for government financing. By 1997-98, the yield from the repayment of contributions will amount to at least $100 million per year.

***. . . resulting in more than $28 billion in spending reductions***

- In addition, the government will not renew Economic and Regional Development Agreements in both forestry and mining as they expire over the next few years. We will also review the future of ERDA agreements in other sectoral areas.

- Operating subsidies will be reduced by $50 million in 1995-96 and $100 million per year thereafter for both the Canadian Broadcasting Corporation and VIA Rail.

- The unemployment insurance benefit rate will be extended at the current level.

- The government, through the Canada Mortgage and Housing Corporation, will not increase its current support of about $2 billion a year for social housing. CMHC will no longer fund housing through 35-year subsidy commitments which impose most of the costs of today's housing support on future taxpayers. Funds to maintain existing housing in good repair, and scope for new commitments, will be found through increased efficiencies in program financing and delivery. CMHC's special purpose funding for shelters for victims of family violence, for housing on Indian reserves and for the integration of persons with disabilities will continue as planned.

***Two major exemptions from restraint measures***

Two major areas representing about $50 billion in annual federal program spending – about 40 per cent of the total – have again been exempted from reductions.

- Income security benefits for the elderly, programs specifically for the disabled, veterans' pensions and allowances, selected native programs, the Canadian Jobs Strategy and famine relief are exempt from cuts.
- In recognition of the national nature of the fiscal problem, no additional restraint is being imposed on major federal transfers to provinces. These transfers will continue to grow at a rate greater than all other federal program spending.

Because the major federal transfers to provinces are expected to grow by 4 per cent over the next five years, provinces will receive about $9 billion more than they would have if these transfers were to be restrained to the same rate of growth as all other federal program spending – 1.5 per cent. For a province like Newfoundland, allowing this higher growth rate in transfers means over $400 million more. That is almost twice the size of Newfoundland's deficit this year and it is equal to $700 for each Newfoundlander.

***Spending Control Act limits lowered***

As promised in the 1992 budget, the government will act to reduce the controlled program spending limits under the *Spending Control Act* to reflect the impact of legislating full funding of pensions and restructuring the child benefit system.

- In addition, the limits under the Act will be further reduced by law to bring them into line with the low inflation environment and to ensure a permanent lowering of government spending. The new lower limits will also be extended to the end of 1997-98.

## Streamlining government

Like Canadian businesses, governments must reduce costs and operate more efficiently. The measures in this budget have been designed to encourage continued improvement.

To provide managers the flexibility to do their jobs and make more effective use of shrinking resources, the government will seek basic changes in the Work Force Adjustment Directive when it meets with the unions this summer for the scheduled triennial review.

***Smaller, more accessible government***

The government will continue to streamline its operations and improve the cost-effectiveness of its service delivery. We will make government smaller, simpler and more accessible to Canadians. Building on the streamlining actions in the 1992 budget, an additional 12 government organizations ranging from large departments to small agencies and advisory bodies are being eliminated or restructured.

We will complete the organizational merger of the two departments of Taxation and Customs and Excise into a single new Department of National Revenue. This will provide for more effective administration of the tax system, including better use of resources to combat tobacco smuggling and to improve compliance generally. Efforts will be stepped up to ensure that taxes owing are paid – and paid in a timely way.

***Restructuring and privatization***

Eight advisory and other bodies whose functions are no longer needed or can be carried out in another way will be eliminated. Two other advisory bodies – the National Advisory Council on Aging and the National Council of Welfare – will be merged.

Since 1984 the government has privatized or dissolved 39 Crown enterprises and other holdings and improved operations for the remainder. The number of full-time Crown corporation employees has been reduced by nearly 90,000. Building on these initiatives, a number of organizations in various areas of government will be considered for privatization or commercialization. Details are in the supplementary information.

In the eyes of the business client, a bewildering array of federal, provincial, municipal and private sector services are being offered, leaving the impression of complexity, overlap, duplication and all-around inefficiency.

In response to these concerns, I announced in the February 1992 budget several initiatives aimed at improving service. As part of this effort, three pilot business centres have been established to provide a single point of contact for business services. The government will be working with other levels of government to provide one of these centres in at least one major urban area in each province. The result will be better service for business and cost savings for governments.

***Less regulatory burden***

In the 1992 budget, the government launched a major review of regulatory programs. This initiative is well advanced. Preliminary analysis of more than 700 regulations suggests that one in four will be struck from the books. An equal number will be modified. These actions will result in substantial cost savings to the private sector and the government. My colleague, the President of the Treasury Board, will provide an update on the progress of this review later this week.

The federal government will encourage all governments to review regulatory programs with the goal of reducing overlap and duplication and ensuring maximum efficiency and benefit for all Canadians.

***Simplified GST system for small business***

Reducing the compliance cost for taxpayers remains a high priority. On December 10, 1992 the government introduced a simplified system for calculating GST input tax credits. Since then, we have continued to work with small businesses. We will be announcing improvements to the Quick Method of GST accounting which will simplify the tax for hundreds of thousands of small businesses.

I am also proposing measures to streamline government and improve cash management.

- The quarterly instalment income tax system will be modified. Some 300,000 persons owing relatively small amounts of tax will no longer have to make instalments. An additional 500,000 higher-income taxpayers will now be required to pay on a quarterly basis.
- Beginning in 1994, the GST Credit for individuals will be paid twice a year – in April and October – instead of quarterly. This will save $7.5 million in administration costs while delivering the same benefit to recipients.

These measures will affect the timing of government payments and receipts. They will not increase taxes.

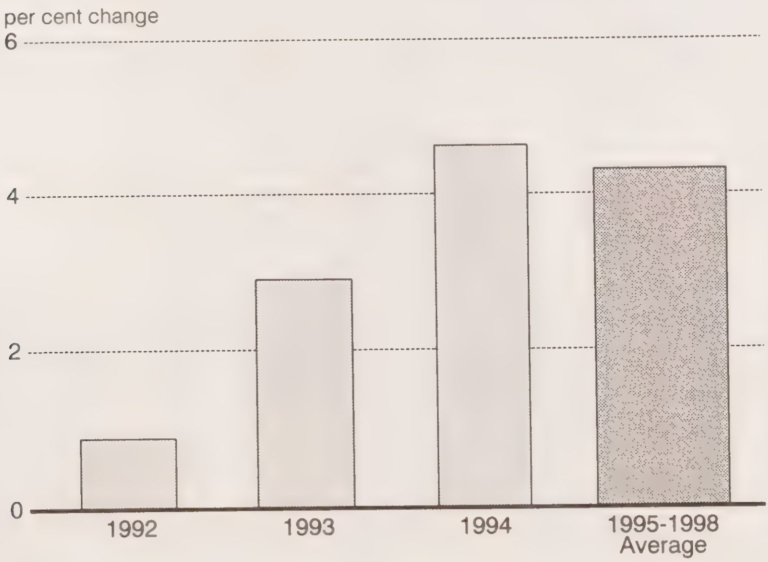
## The economy is poised for sustained, non-inflationary growth

With the help of the measures I have described, and the growing benefits of the government's wide range of economic renewal actions since 1984, the Canadian economy is improving and is poised for strong performance in the years ahead. For example, the OECD has forecast that Canada will have the strongest economic growth among the G-7 industrial countries this year and next.

***Exports drive economy's upturn***

In the past few months, we have seen an encouraging pickup in the pace of economic growth, employment, retail sales and a number of other key indicators. Strongest of all has been our export performance, currently the main force behind the recovery. Our export strength has been underpinned by the dramatic improvement in our cost competitiveness and our increased access to the U.S. market under the Free Trade Agreement. Strong export performance will continue to help the recovery through 1993 and 1994.

**Chart 5**
*Sustained real growth in GDP*



I expect real growth to average close to 3 per cent for 1993, and to increase to more than 4.5 per cent in 1994 as the recovery becomes more broadly based. Domestic demand will be spurred by low interest rates. I expect a strong rebound in both residential investment and business investment.

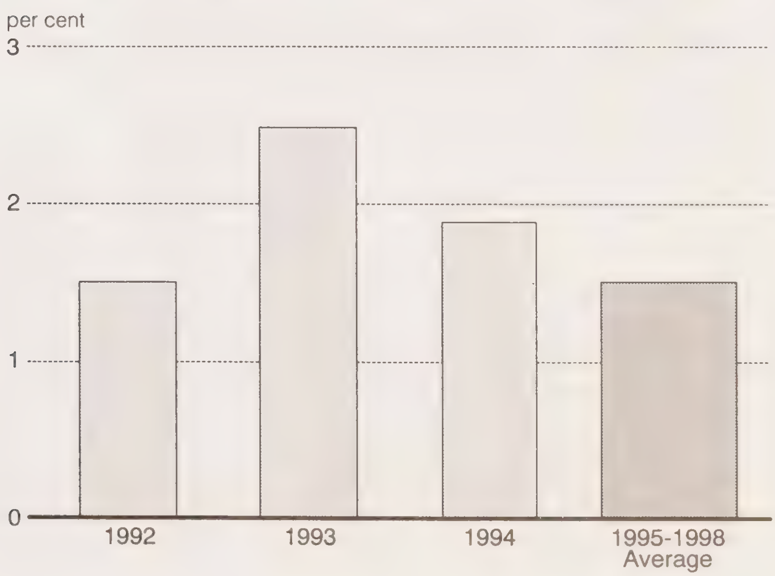
***Improving job prospects***

Job prospects will improve steadily. I expect employment to increase by about 300,000 from the fourth quarter of 1992 to the fourth quarter of this year, and more than 400,000 during 1994. These gains will be accompanied by strong growth in labour productivity resulting from extensive restructuring and the structural policy reforms we have put in place. In the near term, the unemployment rate will decline slowly because of an expected increase in the labour force participation rate.

Inflation will remain low. I expect inflation to average 2.5 per cent in 1993 compared with 1.5 in 1992, reflecting the recent depreciation in the Canadian currency and some provincial indirect tax increases. I expect inflation to decline once again to below 2 per cent in 1994. Sustained low inflation will help keep interest rates low; I expect further declines in long-term rates.

**Chart 6**

*Continued low inflation*



**Low inflation, low interest rates**

For the period from 1995 to 1998, our fiscal projections are based on the following economic assumptions: economic growth at an average rate of 4.25 per cent; a decline in the unemployment rate to 7.5 per cent by 1998; inflation averaging 1.5 per cent; and interest rates remaining low.

These are prudent assumptions. They project real economic output rising over the medium term but still remaining somewhat below the economy's full potential by 1998.

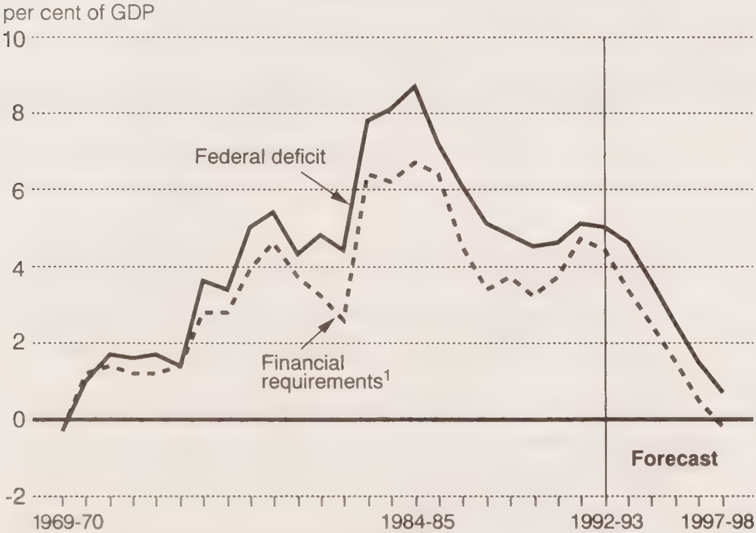
There are uncertainties to be faced, but I believe Canadians can look forward to several years of solid growth and job creation in an environment favourable for confidence, investment and business expansion.

## *Restoring fiscal balance*

The expenditure control measures in this budget will restore the fiscal balance of the federal government over the medium term.

**Chart 7**

*Putting an end to new borrowing*




[1] Excluding foreign exchange transactions.

***Lowest federal spending in 30 years . . .***

Federal program spending will be reduced to 13.9 per cent of Canada's national income in 1997-98, the lowest level in more than 30 years.

- Excluding transfers to provinces, program spending will grow at an average annual rate of only 1.5 per cent, below the projected average inflation rate.

There will be substantial year-over-year reductions in the deficit. As a result:

***. . . and no new borrowing by 1997-98***

- By 1997-98, the government will end all new borrowing in domestic and foreign financial markets and will begin to reduce its publicly held debt.
- Interest payments on the debt will be reduced from a peak of 36 cents for each dollar of revenue in 1990-91 to 26 cents in 1997-98.
- The deficit will be reduced to less than one per cent of national income, down from a level of 5.1 per cent in 1991-92 and 8.7 per cent in 1984-85.

Let there be no doubt: Good fiscal policy is good economic policy; and sustained fiscal progress is essential for sustained economic growth and job creation.

## *Working together for fiscal and economic progress*

All governments in Canada face similar financial problems. And it is worth repeating: There is only one taxpayer.

Decisive action is required now to protect our collective ability to make choices in the future, to preserve our social programs, to create jobs and to ensure a prosperous and competitive economy. For that is the ultimate challenge we all share.

More than ever, Canadians want all governments to work together on the challenges confronting the Canadian economy – and particularly on the national deficit and debt problem. For this is truly a Canadian problem.

I meet regularly with provincial finance ministers to review the state of the economy and the country's finances. These meetings have led to a greater understanding of the fiscal situation each of us faces. We have worked together on the Costs of Government and Expenditure Management, a review of pressures on government spending and experience in addressing these pressures. It underlined the need for a lasting commitment to spending restraint by all levels of government.

But I believe that it is now time to go further. And I note that a number of provincial Premiers have emphasized the need for greater federal-provincial co-operation on practical solutions to Canada's fiscal problems. My conversations with provincial finance ministers have underlined this interest.

***To control buildup of debt co-operative effort is needed***

Consequently, I have invited my provincial and territorial colleagues to a special meeting in Ottawa to begin working on a co-operative approach to the debt problem.

Together we will discuss Canada's national debt and deficit problem and ways to develop practical approaches and solutions.

There are many possible areas for better co-operation: better sharing of information, ideas and experience; finding more efficient ways to deliver services to the public; eliminating wasteful overlap and duplication; improving harmonization; and collecting revenues more efficiently to reduce the compliance burden on Canadians.

In all of these areas, we can do better, and I call on all governments to join in this effort.

## Conclusion

Canadians want less government borrowing, lower taxes, more jobs and more choice for the future.

***Responsible, achievable course of action . . .***

That is what this budget is all about. It charts a responsible, achievable course to increase the job-creating potential of our economy and to secure the financial health of government.

All governments and all taxpayers share that goal. But to achieve it will require national co-operation and sustained, concerted effort.

Canadians have faced some difficult times together. Time and again, our people have pulled together to overcome adversity and build a stronger country.

Today, as a country, we face major economic and financial challenges. But let us remember that we are solidly on course for success. And the signs of progress are growing:

- Canadian businesses are becoming more competitive and Canadian workers more productive;
- exports have surged and employment is rising again;
- inflation is near its lowest level in 30 years; and
- the deficit/debt problem is increasingly being addressed.

***. . . for a stronger, more prosperous Canada***

The foundation for growth, jobs and prosperity in the newly emerging economy is being put into place. It is there to be strengthened and built on, for the greater benefit of all Canadians.

Realism tells us that it will not be easy to win the battle against high deficits and rising debt. But experience shows that Canadians have what it takes to succeed.

With discipline, courage and co-operation, we can achieve the success that will make Canada a stronger, more prosperous country for the balance of this decade and the new century to come.

**Table 1**
*Summary statement of transactions: Budget 1993*

| | 1992-93 | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 |
|---|---|---|---|---|---|---|
| | | | (billions of dollars) | | | |
| Budgetary transactions | | | | | | |
| Budgetary revenues | 122.9 | 126.9 | 135.9 | 147.5 | 156.1 | 163.9 |
| Program spending | -118.9 | -120.0 | -123.1 | -126.2 | -127.6 | -128.6 |
| Operating balance | 4.0 | 6.9 | 12.8 | 21.4 | 28.5 | 35.2 |
| Public debt charges | -39.5 | -39.5 | -41.8 | -42.4 | -42.6 | -43.2 |
| Budgetary deficit | -35.5 | -32.6 | -29.0 | -21.0 | -14.0 | -8.0 |
| Non-budgetary transactions | 1.1 | 6.1 | 9.0 | 8.5 | 8.8 | 9.1 |
| Financial requirements (excluding foreign exchange) | -34.4 | -26.5 | -20.0 | -12.5 | -5.2 | 1.0 |
| Net public debt | 458.6 | 491.2 | 520.1 | 541.2 | 555.2 | 563.2 |
| Gross domestic product | 687.3 | 719.0 | 770.5 | 827.0 | 877.8 | 928.3 |
| | | | (percentage of GDP) | | | |
| Budgetary revenues | 17.9 | 17.7 | 17.6 | 17.8 | 17.8 | 17.7 |
| Program spending | -17.3 | -16.7 | -16.0 | -15.3 | -14.5 | -13.9 |
| Operating balance | 0.6 | 1.0 | 1.7 | 2.6 | 3.3 | 3.8 |
| Public debt charges | -5.7 | -5.5 | -5.4 | -5.1 | -4.8 | -4.7 |
| Budgetary expenditures | -23.0 | -22.2 | -21.4 | -20.4 | -19.4 | -18.5 |
| Deficit | -5.2 | -4.5 | -3.8 | -2.5 | -1.6 | -0.9 |
| Financial requirements | -5.0 | -3.7 | -2.6 | -1.5 | -0.6 | 0.1 |
| Net public debt | 66.7 | 68.3 | 67.5 | 65.4 | 63.2 | 60.7 |

(-) Indicates a net requirement for funds.
(+) Indicates a source of funds.

# Chapter 2: The Economic Outlook

## Summary

### Economy poised for sustained non-inflationary growth

***Recovery now under way***

Canada is now experiencing an economic recovery. Real GDP has grown for seven consecutive quarters and several developments point to sustained non-inflationary growth in the period ahead. Inflation was 1.5 per cent in 1992, a 30-year low and the lowest in the G-7. The reduction in inflationary pressures has allowed a sharp reduction in the rate of growth in wages since 1990. This, combined with the pickup in productivity growth, led to a drop in unit labour cost growth to 1.8 per cent in 1992 from almost 6 per cent in 1990. Government wage and spending restraint, as well as the announcement of inflation-reduction targets, has accelerated the response of prices and wages to market conditions.

***Inflation under control***

Success in reducing inflation permitted a dramatic easing in monetary conditions. Interest rates are close to 20-year lows. The exchange rate is down about 10 per cent from its peak in November 1991.

The substantial improvement in our trade performance led to stronger real growth in the fourth quarter of 1992. Exports will help the recovery in 1993 and 1994 as the international economy, particularly the U.S., strengthens. The domestic economy will continue to strengthen as a result of the past easing in interest rates. Growth is expected to average 2.9 per cent this year and 4.6 per cent in 1994. This is in line with the views of private sector forecasters as well as international agencies such as the International Monetary Fund and the Organization for Economic Co-operation and Development. Although job prospects will improve markedly, both the unemployment rate and excess productive capacity will remain high at the end of 1994.

### Solid growth over the medium term

***Rapid growth without inflation***

The medium-term projection underlying the fiscal plan is based on the assumption that some excess capacity in labour and product markets will remain through 1998. This, combined with low inflation expectations, means that the inflation-reduction targets will be achieved despite rapid growth. Low inflation will sustain low

interest rates. Good trade performance, lower interest rates and fiscal consolidation will lead to a substantial improvement in the current account balance.

## Current economic conditions

### Recovery now under way

***GDP increasing***

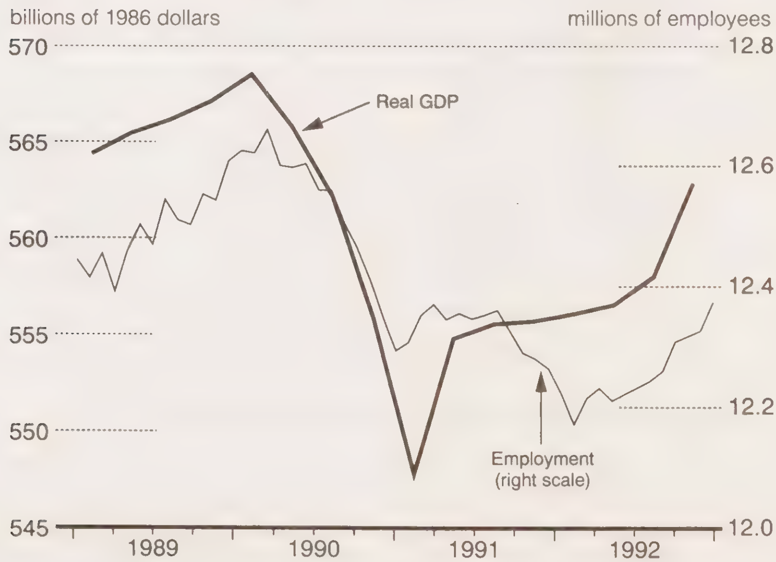
Canada experienced a recession from the second quarter of 1990 to the first quarter of 1991, during which real GDP dropped 3.6 per cent. GDP has grown for seven consecutive quarters since then; on a monthly basis it returned to its previous peak in January of this year.

***Employment growth picked up***

With weak output growth during the recovery, employment did not begin to grow again until May 1992. The employment situation also reflected the restructuring of industry to meet increased global competition. The employment losses during the recovery were concentrated in the goods sector. The pace of job creation has accelerated in the last few months. Since November of last year, employment has grown at an annual rate of 2.8 per cent. (Chart 1)

**Chart 1**

*Real GDP and employment*



# Inflation pressures root cause of the recession

## Increasing domestic costs

Over the 1980s, Canada's productivity performance deteriorated relative to the United States. Yet average Canadian wages grew faster. As a result, unit labour costs in Canadian manufacturing rose twice as fast as in U.S. manufacturing.

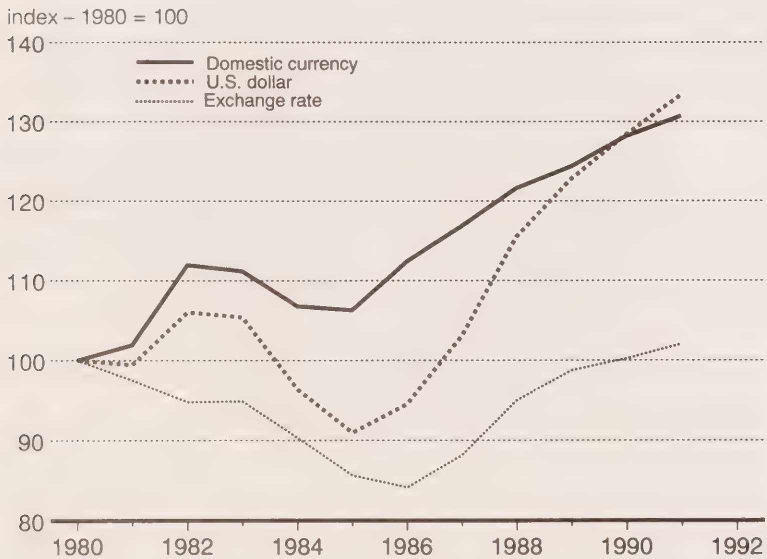
In the early 1980s, a depreciation of the Canadian dollar masked the deterioration in Canada's cost performance. In fact, Canadian unit labour costs measured in U.S. currency did not rise as much as U.S. costs. In the late 1980s, however, the appreciation of the dollar caused a further deterioration in Canada's competitiveness.

***Wage pressures reduced our competitive position . . .***

Movements in the exchange rate, however, are not the source of Canada's longer-term competitive difficulties, nor are they a cure. Indeed, on balance over the 1980s, the exchange rate had little effect on Canada's competitive position against the U.S. The appreciation in the latter half of the decade merely offset the depreciation in the first half. The problem was that unit labour costs in Canada grew faster than in the United States. (Chart 2)

**Chart 2**

*Ratio of Canadian to U.S. manufacturing unit labour costs*



### Rising interest rates

*. . . and led to tighter monetary conditions*

Intensifying inflation pressures also pushed Canadian interest rates higher. From early 1987 to mid-1990, short-term interest rates in Canada almost doubled with the Bank rate reaching 14.05 per cent. Long-term rates also rose significantly.

The result of these rising interest rates was to increase debt-servicing costs of households to record levels and dampen consumer spending on interest-sensitive items, such as durable goods and housing. High interest rates also reduced business spending on investment.

## Factors affecting the recovery

### Weakness in world economy

*Slow growth a worldwide phenomenon*

The U.S. economy fell into a recession in 1990 and recovered very slowly in late 1991 and through the first half of 1992. Only since the second half of 1992 has the U.S. economy showed signs of robust growth. The economies of the European countries and Japan generally weakened later than the North American economies and have yet to emerge from their slowdowns.

The slow growth in the world economy has inhibited recovery in Canada by reducing the demand for Canadian exports and depressing the prices of many of Canada's commodity exports.

### Industrial restructuring for the future

*Meeting challenges of global competition*

The drive by Canadian industry to restructure and increase productivity to meet global competition is essential to allow us to maintain our market position worldwide. While it will benefit the economy in the long term, it has constrained growth in employment in the short term. This has dampened the growth of household disposable incomes and kept consumer confidence low. This, in turn, has meant that the growth of consumer spending has not made as much of a contribution to the recovery as would traditionally be expected.

## International debt

Since 1984, Canada has run generally rising current account deficits – we have been buying more goods and services from other countries than we have been selling. These deficits must be financed by borrowing abroad. The current account deficits since 1984, therefore, have meant a rising level of indebtedness to foreign lenders.

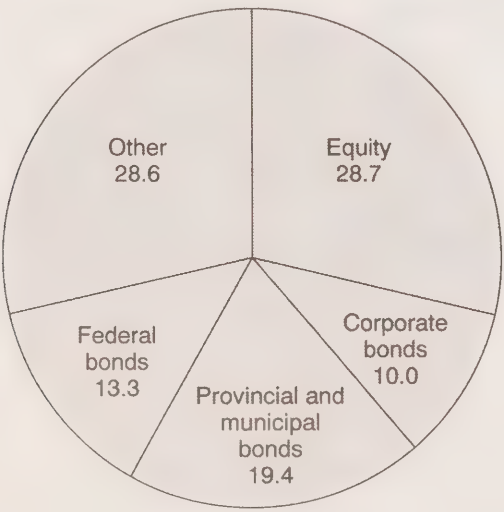
***Canada's debt position affects our economic prospects***

More than 40 per cent of Canada's gross international liabilities in 1992 were held in the form of long-term bonds, about three-quarters of which were issued by the public sector. Although the federal government places very few bond issues abroad, federal bonds are purchased by overseas investors. As a result, the federal government accounts for about a third of bonds held by foreigners, compared to 45 per cent for provincial governments. Similarly, foreigners hold a smaller proportion of federal debt than provincial debt. Equity holdings in the form of direct investment and stocks of Canadian corporations also represent a substantial share of the nation's gross indebtedness. (Chart 3)

**Chart 3**

*Canada's gross international liabilities, 1992*

percentage distribution

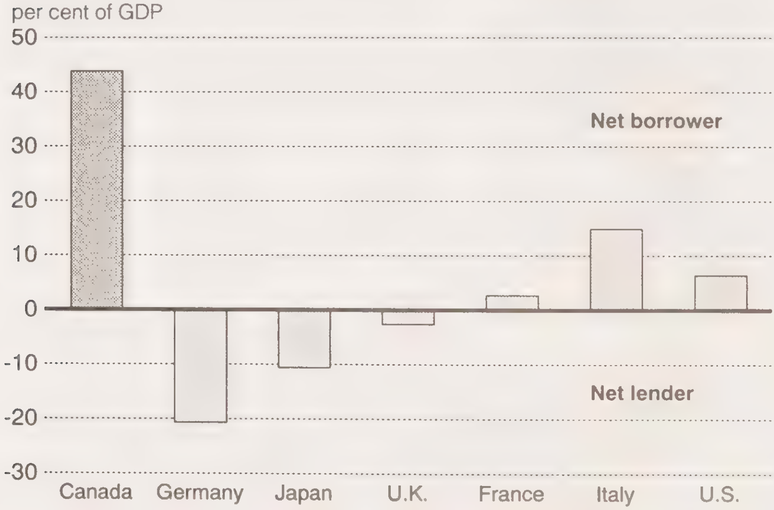


Canada's gross international liabilities are partly offset by foreign assets held by Canadians. Nevertheless, relative to the size of the economy, Canada is now by far the most indebted of the major industrial countries. Further, Canada's net foreign liabilities reached a postwar record in 1992 – 43.8 per cent of GDP. (Chart 4) Its previous peak was 42 per cent in 1961.

Having to rely so extensively on international capital flows has left this country vulnerable to changes in market sentiment by international investors. As evidenced last autumn, these changes in market sentiment can lead to artificially high and volatile interest rates which directly affect Canada's growth prospects.

**Chart 4**

*G-7 countries' net international investment position*[1]




[1]1992 for Canada; 1991 for the United States, Germany, Italy, United Kingdom and Japan; 1990 for France.

## Looking forward to sustained growth

### Low inflation sets the stage

*Inflationary pressures low*

Canada's inflation rate at the end of 1992 was 2.1 per cent, just inside the inflation-reduction target range of 2 to 4 per cent. The slight rise in inflation at year-end reflected the effect of the lower dollar on import prices. This will not, however, be a continued source of inflation pressure.

The decline in inflation in response to the slack in the economy was speeded up and reinforced by our continued commitment to complementary policies such as the announcement of inflation-reduction targets, public service wage restraint, and government expenditure restraint.

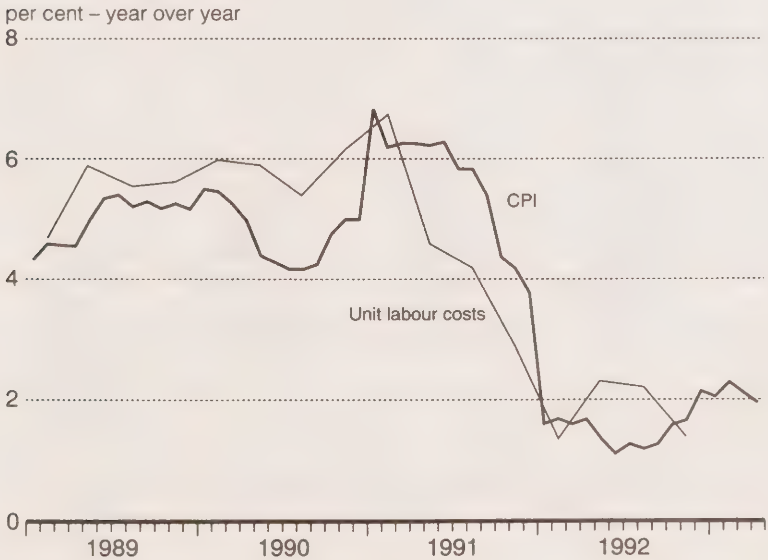
### Cost performance improves

*Turnaround in unit labour costs*

Inflation initially declined through a squeeze on profit margins and an appreciating dollar. While costs were slow to respond, by 1992 wage settlements averaged 2.1 per cent. Further, productivity growth has picked up, resulting in a dramatic slowing in unit labour cost growth. (Chart 5)

**Chart 5**

*CPI inflation rate and unit labour cost growth*



## Monetary conditions ease

*Interest rates near 20-year low . . .*

Canada's good inflation performance has allowed a major easing in monetary conditions since mid-1990. In early September 1992, short-term interest rates were at their lowest levels in 20 years.

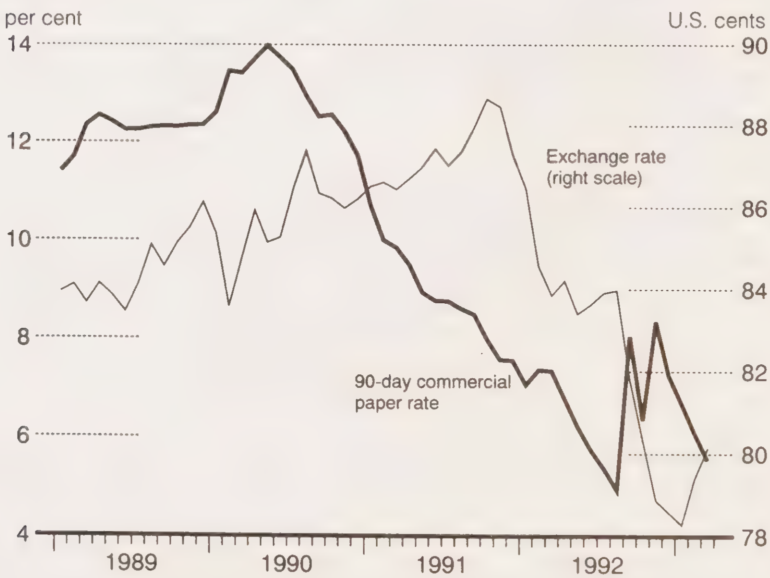
Volatility in foreign exchange markets, however, caused a spike in interest rates in the fall. (Chart 6) The volatility originated in Europe but spilled over to affect the Canadian dollar. Foreign concerns about private and public debts also affected the dollar. After this period of weakness, the dollar strengthened to around U.S. $0.80. This, however, is still down about 10 per cent from its peak in November 1991.

*. . . and falling*

Interest rates have resumed their downward trend. The chartered banks' prime lending rate has fallen to 6 per cent, a 20-year low. The 90-day commercial paper rate is nearing September's 20-year low. Yields on long-term government bonds are now at their lowest levels in 19 years, reflecting declines in U.S. long-term rates and improved inflation expectations in Canada.

**Chart 6**

*Interest and exchange rates*



## U.S. recovery is strengthening

*Canada will benefit from growth of foreign economies*

The U.S. economy showed considerable strength in the second half of 1992 when real GDP rose at an annual rate of more than 4 per cent. Growth is expected to moderate from this rapid pace but remain above the U.S. economy's potential growth rate of just over 2.0 per cent, averaging 3.1 per cent in 1993 and 3.0 per cent in 1994. This will still leave some excess productive capacity at the end of 1994. Consequently, inflation pressures are expected to remain in check, allowing the CPI inflation rate to remain at, or below, 3 per cent in the near term.

Economic conditions in Germany, Japan and the United Kingdom deteriorated markedly over the past year. While conditions are expected to improve slightly in Japan and the U.K., Germany will likely see a further decline in economic activity in 1993. Economic performance in both Japan and Europe is expected to improve in 1994 as a result of the fiscal stimulus package recently introduced in Japan, the expected easing in monetary conditions in Europe, and the strengthening U.S. economy. (Chart 7)

**Chart 7**

*Real GDP/GNP growth in the United States and overseas economies*

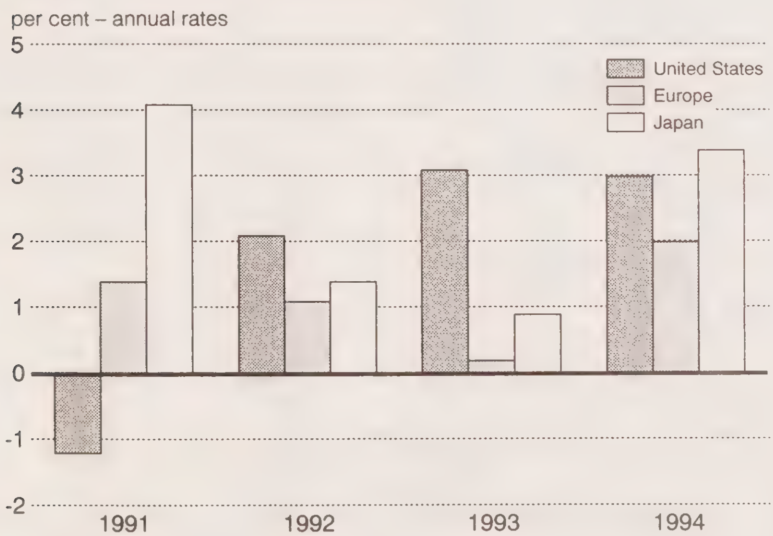


**Table 1**
*The Canadian economic outlook:*
*Main economic indicators, 1992 to 1994*

| | 1992 | 1993 | 1994 |
|---|---|---|---|
| | (per cent change unless otherwise specified) | | |
| Expenditures (volumes) | | | |
| Gross domestic product | 0.9 | 2.9 | 4.6 |
| Consumption | 1.0 | 1.7 | 3.2 |
| Residential investment | 7.4 | 2.6 | 14.9 |
| Business non-residential investment | -4.9 | -1.4 | 9.5 |
| Machinery and equipment | 2.2 | 7.4 | 11.9 |
| Non-residential construction | -15.7 | -17.7 | 3.6 |
| Government expenditure | 1.9 | 1.2 | 0.7 |
| Final domestic demand | 0.8 | 1.2 | 4.1 |
| Inventory change (contribution to growth; per cent) | -0.5 | 0.6 | 0.4 |
| Exports | 8.2 | 5.6 | 4.4 |
| Imports | 5.5 | 1.8 | 3.9 |
| Net exports change (contribution to growth; per cent) | 0.7 | 1.2 | 0.1 |
| Current account balance | | | |
| (billions of current dollars) | -29 | -24 | -21 |
| (per cent of GDP) | -4.2 | -3.4 | -2.7 |
| Housing starts | | | |
| (thousands of units) | 168 | 182 | 221 |
| Prices and costs | | | |
| Annual average | | | |
| Consumer price index (CPI) | 1.5 | 2.5 | 1.9 |
| CPI excluding food and energy | 2.1 | 2.4 | 1.9 |
| GDP deflator | 1.0 | 1.6 | 2.4 |
| Labour income per employee | 3.6 | 2.9 | 2.7 |
| Unit labour costs | 1.8 | 1.7 | 1.1 |
| Fourth over fourth | | | |
| CPI | 1.8 | 2.7 | 1.6 |
| CPI excluding food and energy | 1.8 | 2.7 | 1.6 |
| Labour market | | | |
| Labour force | 0.3 | 1.4 | 2.7 |
| Employment | -0.8 | 1.7 | 3.0 |
| Unemployment rate (per cent; fourth quarter level) | 11.5 | 11.1 | 10.7 |
| Incomes | | | |
| Real personal disposable income | 0.4 | 0.5 | 2.7 |
| Corporate profits before taxes | 6.7 | 25.8 | 28.1 |
| Personal savings rate (per cent) | 10.2 | 9.2 | 8.8 |
| Financial market (per cent) | | | |
| 90-day commercial paper rate (per cent) | | | |
| Nominal | 6.7 | 5.3 | 5.0 |
| Real[1] | 5.2 | 2.8 | 3.1 |
| Long-term government bond rate | | | |
| Nominal | 8.8 | 7.7 | 6.7 |
| Real[1] | 7.3 | 5.2 | 4.8 |

[1] Nominal rate minus CPI inflation rate.

## Short-term outlook

### Real growth will strengthen

*Recovery taking hold across all sectors*

After five quarters of slow growth, real GDP grew an annualized 3.5 per cent in the fourth quarter of 1992, led by strong exports. Real GDP is expected to grow strongly through the near term, rising 3.8 per cent from the fourth quarter of 1992 to the fourth quarter of 1993. On an annual average basis, growth will average 2.9 per cent this year and strengthen to 4.6 per cent in 1994. The strengthening in growth will originate in the trade sector but become more broadly based by 1994.

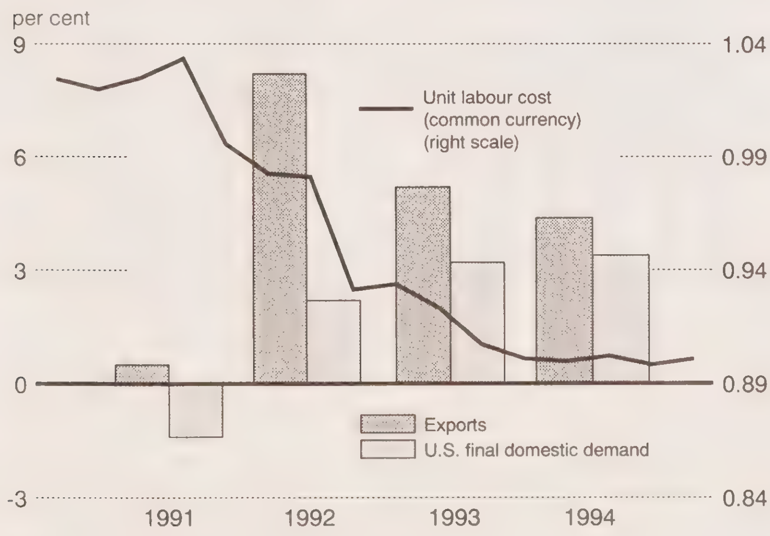
### Strong export performance will continue

*Exports – a key part of our success*

Real exports were a source of considerable strength in 1992, rising 8.2 per cent. This reflected in part the dramatic improvement in Canada's cost competitiveness as measured by the difference in unit labour costs between Canada and the U.S. Increased access to the large U.S. market as a result of the Free Trade Agreement with the United States was also important. Further improvement in Canada's cost competitiveness, together with stronger growth in the U.S. in the near term, will help sustain strong growth in real exports. (Chart 8)

**Chart 8**

*Canadian real exports, U.S. final domestic demand, and Canada-U.S. unit labour cost ratio*



## Low interest rates will spur consumer spending

*Rebound in domestic demand*

Low interest rates will spur growth by reducing borrowing costs and by increasing consumer confidence. Growth in consumer spending is expected to average 1.7 per cent in 1993, rising to 3.2 per cent in 1994. Growth in consumer spending will outstrip real personal disposable income growth, indicating a steady decline in the savings rate in response to lower interest rates and improved consumer confidence.

## Residential investment will rebound strongly

Residential investment is expected to rebound strongly, with housing starts averaging 182,000 this year and 221,000 in 1994. The rise in demand for new housing will be spurred by: increased housing affordability owing to lower financing costs and modest increases in housing prices; the reduction of the minimum down payment on CMHC-approved mortgages for first-time home buyers to 5 per cent; and extension of the policy of allowing the use of RRSP funds for down payments. There is a large pent-up demand for housing, after three years of starts below demographic requirements.

## Business investment will strengthen in 1994

Excess supply of office space and industrial structures is expected to lead to a further sharp decline in spending on non-residential construction in 1993. Investment in machinery and equipment, however, will continue to grow at a robust pace of 7.4 per cent this year. In 1994, rising profit margins, lower capital costs and rising utilization rates will underpin an increase in spending on both machinery and equipment and non-residential construction.

## Job prospects will improve markedly and productivity growth will remain strong

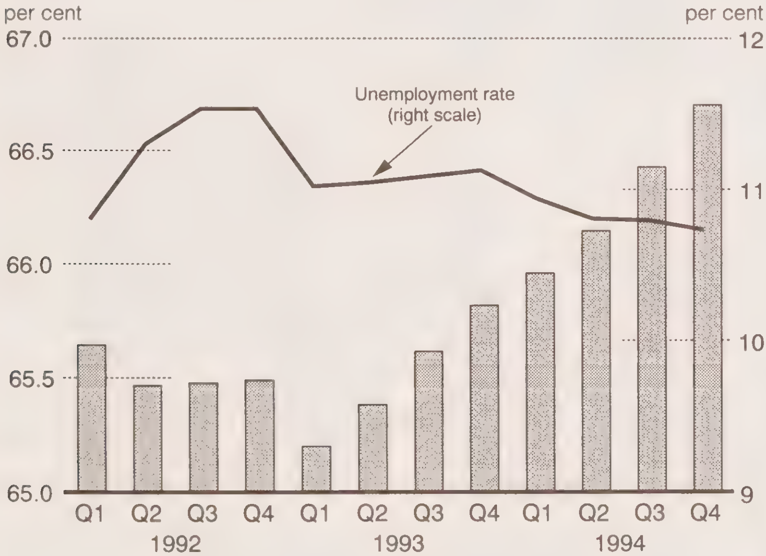
*More jobs for Canadians – now and in the future*

In line with the pickup in real growth, employment is expected to rise steadily through the near term, increasing roughly 300,000 from the fourth quarter of 1992 to the fourth quarter of this year, and an additional 410,000 by the end of 1994. The employment gains will be accompanied by strong growth in labour productivity, well above the average growth of 0.9 per cent realized in the second half of the 1980s. The improved productivity performance results from extensive restructuring associated with globalization of economic activity, as well as the recent structural reforms implemented by the federal government.

However, the expected rebound in the labour force participation rate, owing to the re-entry of workers who dropped out due to poor job prospects, means that the unemployment rate will remain high in the near term. (Chart 9)

**Chart 9**

*Participation rate and unemployment rate*



## Inflation pressures will remain low

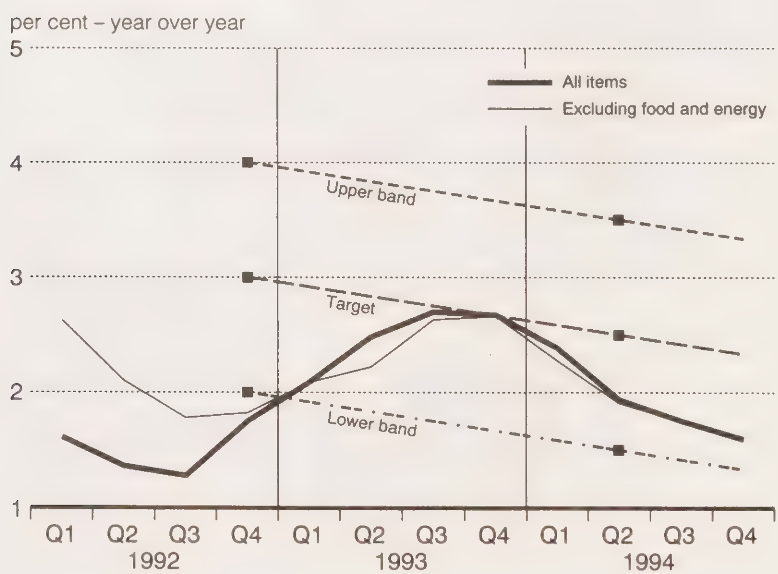
*Canada will continue to meet its inflation targets*

Inflation is expected to rise from 1.5 per cent in 1992 to 2.5 per cent in 1993, owing to the recent depreciation in the Canadian currency and the announced and expected increases in indirect taxes in a number of provinces. Despite rapid growth in 1994, inflation is expected to fall as continuing excess supply in both product and labour markets, combined with the government's firm anti-inflation policies, will keep underlying inflation pressures low. Year-over-year inflation is not expected to rise above the mid-point of the target band through the near term. (Chart 10)

The lower wage pressures resulting from lower inflation will combine with improved productivity performance to continue easing the growth of unit labour costs. This will help rebuild profit margins without jeopardizing progress against inflation. Profit margins were squeezed dramatically through the recession and the following weak recovery but are expected to rise steadily through the near term.

**Chart 10**

*The consumer price index*



## Low inflation will keep interest rates low

**_Low interest rates to continue_**

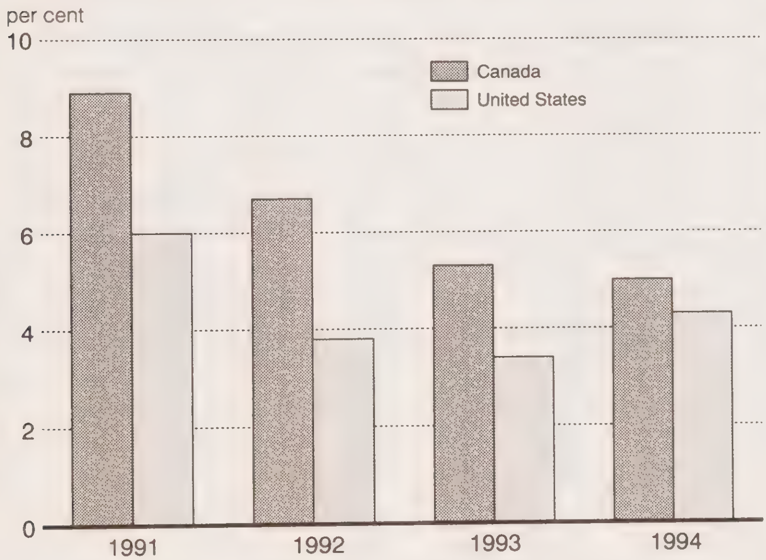
Short-term interest rates have come down about 350 basis points since November 1992. The sustained low inflation will consolidate these declines. The 90-day commercial paper rate is assumed to average just over 5 per cent in 1993 and 5 per cent thereafter. The difference between Canadian and U.S. interest rates is expected to fall from 293 basis points in 1992 to 70 basis points in 1994. (Chart 11)

**_Spreads relative to U.S. also continue to narrow_**

Rates on long-term Government of Canada bonds are also expected to fall steadily through the near term. This is due to the favourable underlying fundamentals in the Canadian economy, particularly an inflation rate that will have been consistently below the rate of inflation in the United States for almost three years, as well as an expected decline in U.S. long-term rates.

**Chart 11**

*Canadian and U.S. short-term interest rates*



## The current account balance will improve

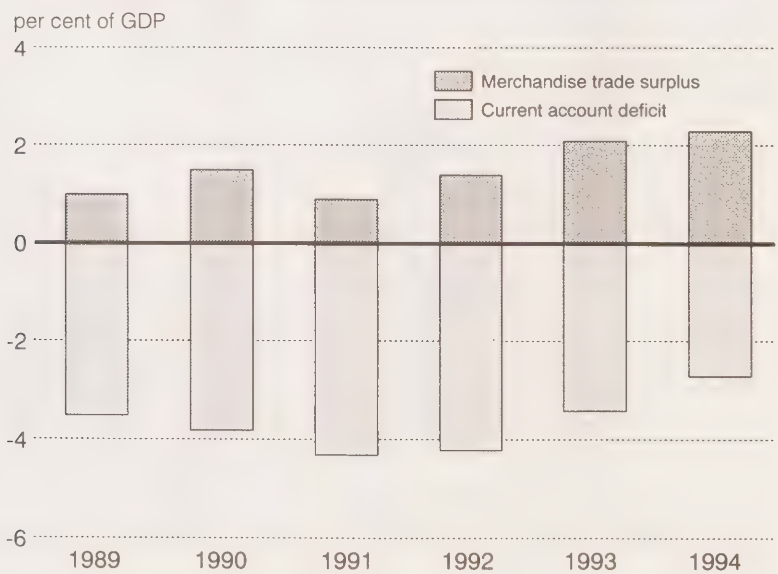
*Many factors contribute to current account turnaround*

The current account deficit is expected to fall steadily through the near term, due to the following factors:

- The merchandise trade surplus is expected to rise markedly through the near term as slower growth in unit labour costs in Canada than in the United States improves the competitiveness of exports and import-competing goods. (Chart 12) This improvement in the trade surplus will occur despite the negative impact on the merchandise balance of the stronger domestic demand expected in Canada.
- The past and projected easing in both short-term and long-term interest rates will reduce interest payments on Canada's international debt.
- Commodity prices and hence Canada's terms of trade are expected to begin to rise in the second half of this year, due to strengthening economic activity in the major industrial countries.

**Chart 12**

*The current account deficit and merchandise trade surplus*



## The short-term outlook is in line with the private sector consensus

*Experts agree our prospects bright . . .*

The Department of Finance regularly conducts surveys of private sector forecasts. The following two charts (Charts 13 and 14) compare the Finance forecast with the consensus, or average, of 19 private sector forecasts from our most recent survey. The comparison conducted in mid-April shows that:

- The short-term outlook presented in this budget is broadly consistent with the consensus view.

*. . . for growth*

- Both Finance and the consensus expect growth to strengthen through the near term. The consensus forecast of real GDP growth in 1993 is slightly stronger than the Finance forecast. In 1994, however, while both expect a sharp pickup, the consensus forecasts 4.0 per cent growth and Finance 4.6 per cent.

*. . . for jobs*

- Similar to Finance's forecast, the private sector expects only a modest decline in the unemployment rate in the near term, due to the expected rise in the labour force participation rate.

*. . . for continued low inflation*

- The consensus forecast for inflation is somewhat higher than Finance's in 1994, but the private sector forecasters agree that the inflation-reduction targets will be achieved.
- Consistent with the low inflation rate expected in the near term, interest rates are expected to remain low, but the consensus is less optimistic than Finance, particularly in 1994. The consensus is also less optimistic in terms of real interest rates, expecting them to average about ½ percentage point above the Finance forecast in both 1993 and 1994.

**Chart 13**

*Private sector forecasts, 1993*

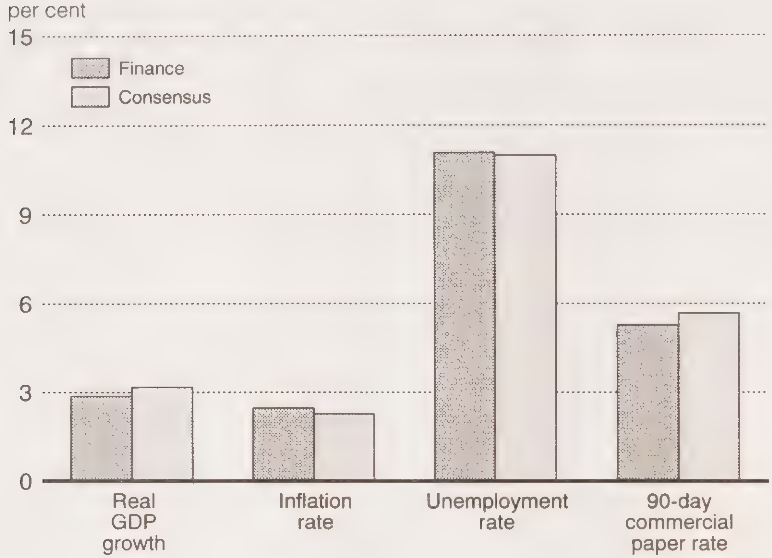
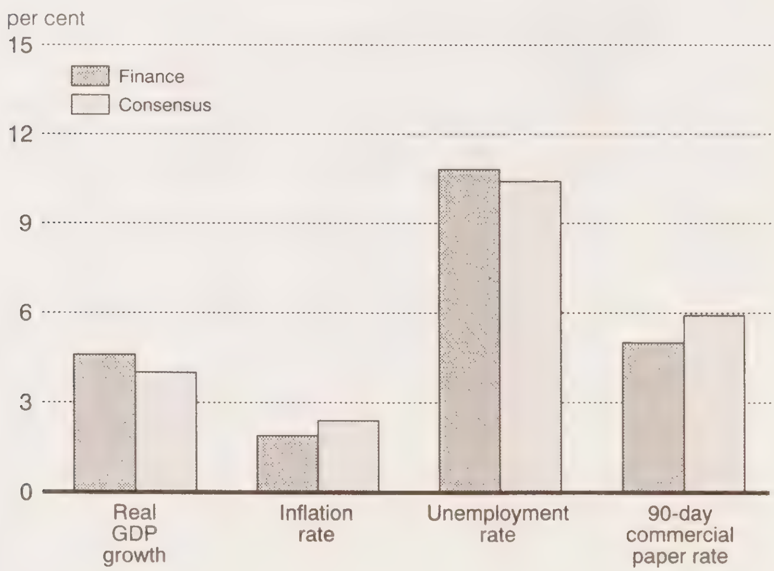



**Chart 14**

*Private sector forecasts, 1994*



## Medium-term projection

### Real output remains below potential over the medium term

*Rapid growth required to eliminate excess capacity*

Potential output – the maximum output when the economy's resources are fully used – is estimated to expand 3 per cent a year on average over the present business cycle. Growth below this rate would result in an increasing gap between potential and actual real GDP. This gap is essentially a measure of the unused productive capacity of the economy. The recession and the following weak recovery led to a gap of about 7 per cent by the end of 1992. The gap is expected to narrow to about 4½ per cent by the end of 1994. Although the gap will eventually be closed, the speed at which it will close is difficult to forecast.

Closing the gap by the end of 1998 would require real GDP growth of about 4¾ per cent a year from 1995 to 1998. If the gap were to close as fast as in the previous recovery, real GDP growth would have to average above 5 per cent in 1995 and 1996. This would close the gap by the end of 1996.

## Medium-term growth is projected to average 4¼ per cent

*All signs point to steady expansion benefiting all Canadians*

The medium-term economic outlook underlying the fiscal track presented in this budget projects real growth of 4¼ per cent a year, with the unemployment rate falling to 7½ per cent by 1998. This projection is based on the assumption that real output will gradually approach its potential level, leaving a gap of about 1¾ per cent by 1998 – seven years after the end of the 1990-1991 recession.

Consistent with this real growth projection, inflation is expected to average 1½ per cent over the medium term, below the target rate of 2 per cent for the end of 1995. This is due to continued excess capacity and the fact that by 1994, after three years of minimal inflation, Canadians will have adjusted their expectations about future inflation rates.

The medium-term projection assumes that real interest rates will remain higher than their historical averages. The real 90-day commercial paper rate is assumed to average 3½ per cent a year, compared with an average of 2¾ per cent from 1960 to 1989, while the real government long-term bond rate is assumed to average 4½ per cent a year, compared with 3¼ per cent from 1960 to 1989.

**Table 2**

*Medium-term economic projection: Selected economic indicators, 1992 to 1998*

| | | | | Average |
|---|---|---|---|---|
| | 1992 | 1993 | 1994 | 1995-1998 |
| | (per cent change unless otherwise specified) | | | |
| Real GDP | 0.9 | 2.9 | 4.6 | 4.3 |
| Employment | -0.8 | 1.7 | 3.0 | 3.1 |
| Unemployment rate (%)[1] | 11.3 | 11.1 | 10.8 | 7.5 |
| Inflation (CPI) | | | | |
| Total | 1.5 | 2.5 | 1.9 | 1.5 |
| Excluding food and energy | 2.0 | 2.4 | 1.9 | 1.5 |
| 90-day commercial paper rate (%) | | | | |
| Nominal | 6.7 | 5.3 | 5.0 | 5.0 |
| Real[2] | 5.2 | 2.8 | 3.1 | 3.5 |
| Long-term government bond rate (%) | | | | |
| Nominal | 8.8 | 7.7 | 6.7 | 6.0 |
| Real | 7.3 | 5.2 | 4.8 | 4.5 |

[1] 1995-1998 average is the level in 1998.
[2] Nominal rate minus CPI inflation rate.

## Fundamentals improve over the medium term

A substantial reduction in the structural imbalance between savings and investment that has plagued the Canadian economy is projected over the medium term. Improved trade performance, the federal government's commitment to deficit reduction, and the projected improvement in the fiscal position of the other levels of government will allow domestic savings to replace foreign savings as the main source of financing the increase in investment that the Canadian economy needs. (Chart 15)

***Sound economic policies deliver improved fundamentals***

If the output gap were to close faster than assumed here, progress in eliminating imbalances would be even more pronounced.

**Chart 15**

*Sources and uses of savings*

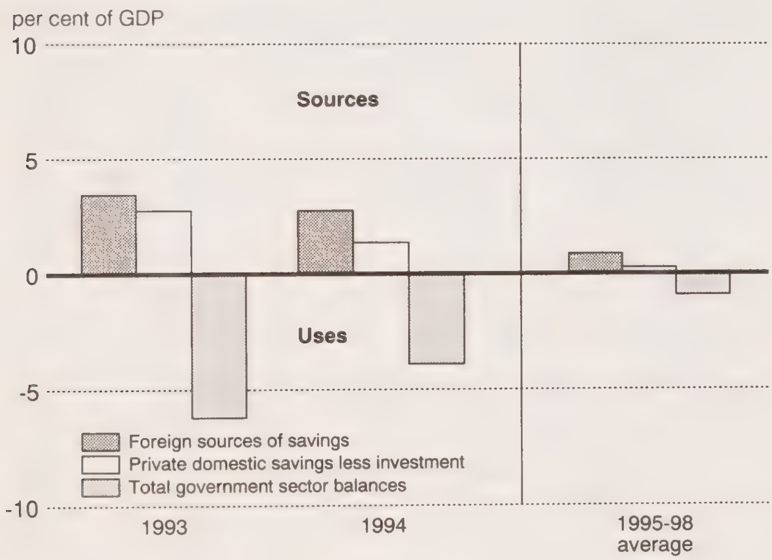


**Table 3**
*Main economic indicators, 1987 to 1992*

| | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 |
|---|---|---|---|---|---|---|
| | (per cent change unless otherwise specified) | | | | | |
| Expenditures (volumes) | | | | | | |
| Gross domestic product | 4.2 | 5.0 | 2.3 | -0.5 | -1.7 | 0.9 |
| Consumption | 4.4 | 4.5 | 3.2 | 0.9 | -1.7 | 1.0 |
| Residential investment | 16.4 | 2.8 | 4.2 | -9.1 | -11.8 | 7.4 |
| Business non-residential investment | 9.7 | 15.8 | 6.4 | -3.3 | -1.4 | -4.9 |
| Machinery and equipment | 15.0 | 19.2 | 7.4 | -5.6 | 0.5 | 2.2 |
| Non-residential construction | 3.0 | 11.0 | 4.8 | 0.5 | -4.1 | -15.7 |
| Government expenditure | 1.8 | 4.1 | 4.2 | 3.4 | 2.0 | 1.9 |
| Final domestic demand | 5.1 | 5.6 | 3.9 | 0.2 | -1.4 | 0.8 |
| Inventory change (contribution to growth; per cent) | 0.1 | -0.1 | 0.3 | -1.3 | 0.6 | -0.5 |
| Exports | 3.5 | 9.5 | 0.9 | 4.1 | 0.5 | 8.2 |
| Imports | 7.0 | 13.8 | 6.4 | 1.9 | 2.2 | 5.5 |
| Net exports change (contribution to growth; per cent) | -0.9 | -1.2 | -1.6 | 0.6 | -0.6 | 0.7 |
| Current account balance | | | | | | |
| (billions of current dollars) | -12 | -15 | -23 | -26 | -29 | -29 |
| (per cent of GDP) | -2.1 | -2.6 | -3.5 | -3.8 | -4.3 | -4.2 |
| Housing starts | | | | | | |
| (thousands of units) | 245 | 221 | 216 | 184 | 152 | 168 |
| Prices and costs | | | | | | |
| Annual average | | | | | | |
| Consumer price index (CPI) | 4.4 | 4.0 | 5.0 | 4.8 | 5.6 | 1.5 |
| CPI excluding food and energy | 4.6 | 4.8 | 5.5 | 4.5 | 5.8 | 2.0 |
| GDP deflator | 4.7 | 4.6 | 4.8 | 3.3 | 2.7 | 1.0 |
| Labour income per employee | 5.7 | 6.3 | 5.8 | 4.6 | 4.7 | 3.6 |
| Unit labour costs | 4.4 | 4.5 | 5.4 | 5.9 | 4.6 | 1.8 |
| Fourth over fourth | | | | | | |
| CPI | 4.2 | 4.1 | 5.3 | 4.9 | 4.1 | 1.8 |
| CPI excluding food and energy | 4.3 | 5.1 | 5.4 | 4.2 | 5.1 | 1.8 |
| Labour market | | | | | | |
| Labour force | 2.1 | 2.0 | 1.7 | 1.3 | 0.6 | 0.3 |
| Employment | 2.9 | 3.2 | 2.0 | 0.7 | -1.8 | -0.8 |
| Unemployment rate (per cent; fourth quarter level) | 8.2 | 7.7 | 7.6 | 9.2 | 10.4 | 11.5 |
| Incomes | | | | | | |
| Real personal disposable income | 2.8 | 5.1 | 4.5 | 0.8 | -1.7 | 0.4 |
| Corporate profits before taxes | 24.7 | 14.3 | -6.6 | -24.6 | -30.2 | 6.7 |
| Personal savings rate (per cent) | 9.1 | 9.5 | 10.2 | 10.0 | 10.3 | 10.2 |
| Financial market (per cent) | | | | | | |
| 90-day commercial paper rate (%) | | | | | | |
| Nominal | 8.4 | 9.7 | 12.2 | 13.0 | 8.9 | 6.7 |
| Real[1] | 4.0 | 5.6 | 7.2 | 8.3 | 3.3 | 5.2 |
| Long-term government bond rate | | | | | | |
| Nominal | 9.9 | 10.2 | 9.9 | 10.9 | 9.8 | 8.8 |
| Real[1] | 5.6 | 6.2 | 4.9 | 6.1 | 4.2 | 7.3 |

[1] Real interest rates are defined as the nominal rates minus the percentage change in the consumer price index.

# Chapter 3: Canada's Fiscal Situation and Outlook

## ■ *Overview*

Economic growth following the 1990-1991 recession has been considerably weaker than experienced in previous recoveries. The economic outlook, presented in Chapter 2, is for sustained non-inflationary expansion through 1998, but the economy is not projected to return to full capacity utilization by then. This, in combination with low and stable inflation, indicates much lower government revenues than forecast in the February 1992 budget.

The December 1992 Economic and Fiscal Statement contained actions to limit short-term slippage of the deficit from the February 1992 budget projections.

***Meeting our targets . . .***

The present budget extends and deepens these actions to keep the 1993-94 deficit to the December forecast and will eliminate all net new borrowings by the federal government within the next five years.

***. . . with no tax increases and***

This will be achieved through wide-ranging expenditure reductions. As in the December 1992 Statement, there are no tax increases.

The expenditure reductions announced in this budget build on those introduced in December. Together, they will ensure that:

***. . . spending growth in line with inflation***

- total program spending growth over the next five years will be 1.7 per cent a year, in line with the expected inflation rate; and
- as a percentage of gross domestic product (GDP), program spending will fall to the lowest ratio in over 30 years.

## Fiscal excesses before 1984-85 caused the deficit-debt spiral

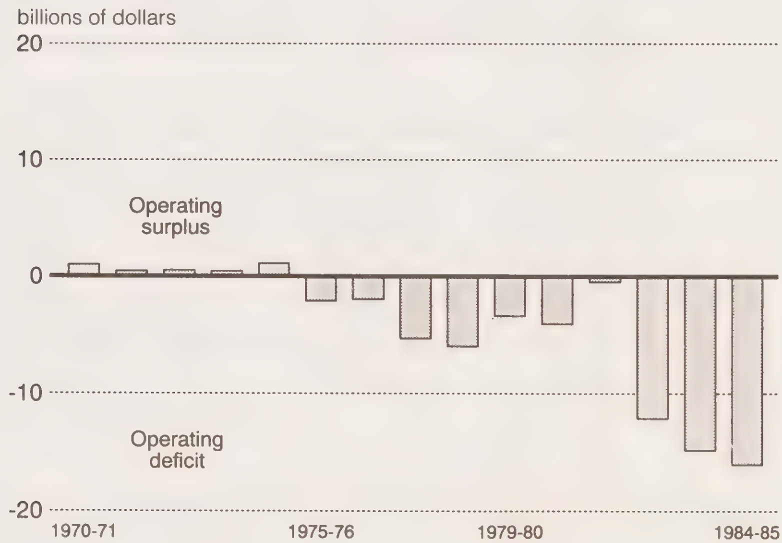
***Excessive growth of program spending***

In the 15 years before 1984-85, program spending – total budgetary expenditures less public debt charges – increased by an average of almost 14 per cent a year, 6 percentage points faster than inflation.

Deterioration in the revenue yield, due to numerous discretionary tax measures and flaws in the manufacturers' sales tax, compounded the government's growing fiscal problem.

The 1981-1982 recession worsened the fiscal imbalance. By 1984-85, the deficit had soared to a postwar high of 8.7 per cent of GDP; net public debt was spiralling upwards at an average annual rate of over 22 per cent. This resulted in an 11-fold increase in federal debt between 1968-69 and 1984-85. The operating balance, the difference between revenues and spending on programs, was in deficit to the tune of 3.6 per cent of GDP. (Chart 1)

**Chart 1**
*A growing gap between program spending and revenues*



### Deficits call for resolute action

***The burden of debt***

The government understood the gravity of this situation in 1984. Failure to right the fiscal imbalance would have had devastating consequences, in the form of sharply lower growth and standards of living.

If government borrowing finances current consumption rather than productive investment, it lowers taxpayers' disposable incomes in the future. Government deficits are not taxes avoided but taxes postponed.

Borrowing requirements lead to increased reliance on foreign capital markets, as the stock of domestic savings is limited. This also imposes a burden on the domestic economy since the servicing costs associated with international debt mean that part of the income produced in Canada every year is not available for domestic consumption and investment.

The inevitable outcome of increased government demand for funds is also higher interest rates which mean lower private sector investment and a smaller capital stock, fewer jobs, and lower economic growth.

As deficits persist, they lead to ever-increasing debt and debt-servicing burdens. More and more of the government's revenue base is appropriated by interest charges, reducing the government's ability to finance essential programs and services for Canadians.

## The fiscal strategy and achievements

### Sharp turnaround in operating balance

In the fall of 1984, the government responded to the fiscal challenge with *A New Direction for Canada: An Agenda for Economic Renewal*. The Agenda set out a planning framework to restore control over the fiscal situation and introduced complementary structural policies to increase Canada's economic potential.

***Operating balance in surplus***

During the period 1984-85 to 1989-90, significant fiscal progress was made. The operating deficit of 3.6 per cent of GDP in 1984-85 was transformed into a surplus of 1.5 per cent of GDP, a turnaround amounting to a full 5.1 per cent of GDP. (Chart 2)

**Chart 2**

*A marked turnaround in the operating balance after 1984-85*

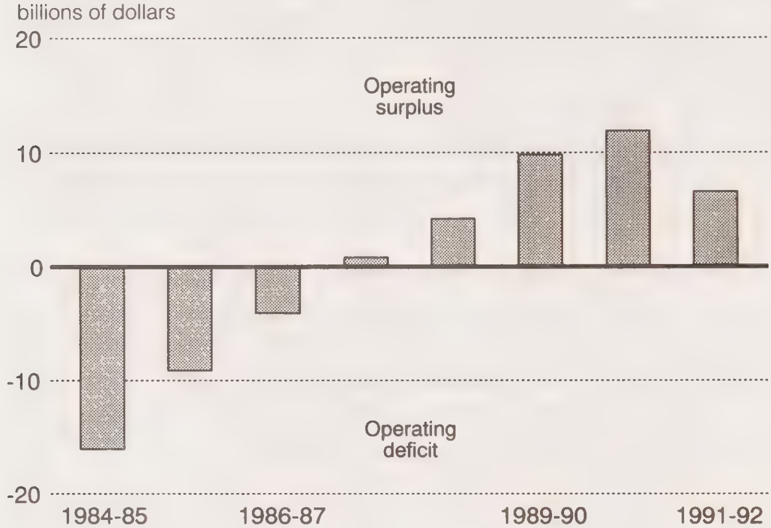
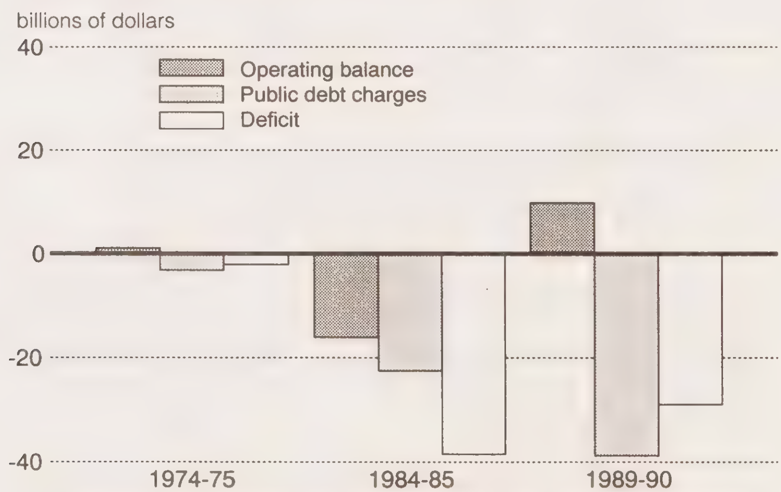



**Chart 3**

*The budgetary deficit, public debt charges and the operating balance*[1]




[1] Operating balance is the budgetary deficit excluding public debt charges, i.e., budgetary revenues less program spending.

By 1989-90, the government was spending less on programs than it was bringing in through taxes – 98.6 cents per tax dollar, compared with spending of $1.33 per dollar in 1984-85.

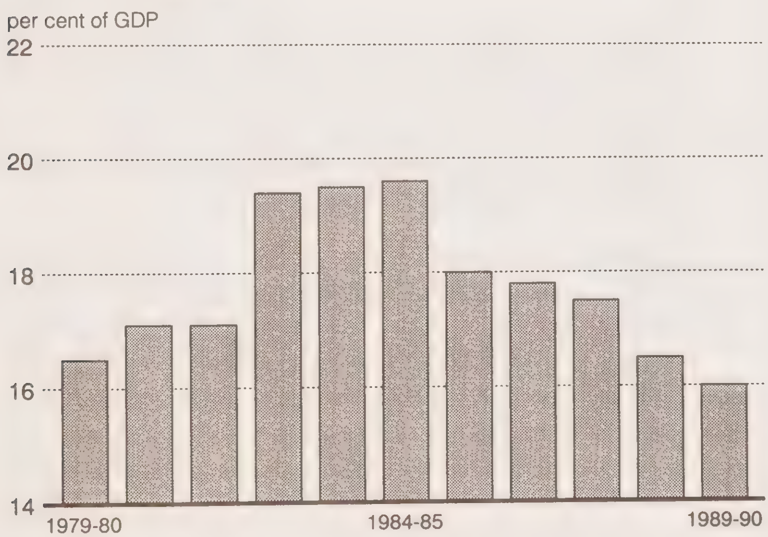
The impact of compound interest on deficits and debt led to rapid growth of debt charges after 1985 and drained away much of the gain from fiscal restraint. Of the $26.1 billion improvement in the operating balance between 1984-85 and 1989-90, roughly $16 billion was required simply to pay the increased interest charges on the public debt, leaving only $10 billion to reduce the deficit. (Chart 3)

## Program spending restraint was key move

***Spending under control***

Success was particularly evident in restraining federal program expenditures, the cornerstone of the fiscal strategy. Program spending was reduced to 16 per cent of GDP in 1989-90 from over 19.6 per cent in 1984-85. (Chart 4)

**Chart 4**
*Program expenditures*
*1979-80 to 1989-90*



### Revenue yield restored and stabilized

Budget measures after 1984 restored the revenue yield from about 16 per cent of GDP in the mid-1980s to 17.5 per cent by 1989-90, about the average of the 1970s.

## Confronting renewed fiscal pressures after 1989-90

Despite the government's fiscal achievements through 1989-90, renewed pressures emerged. Beginning in 1989, strong inflation pressures and their impact on interest rates produced substantially higher public debt charges. In addition, the economy entered into recession in the second quarter of 1990 putting substantial pressure on the cyclically sensitive components of government revenues and expenditures.

### Expenditure Control Plan in the 1990-1992 budgets

***Broad-based spending actions to tackle deficit***

The government took actions to stem a serious deterioration of the fiscal situation, under the twin pressures of inflation and recession. The Expenditure Control Plan, introduced in the February 1990 budget and extended, broadened and deepened in the 1991 and 1992 budgets, reduced, froze at 1989-90 levels, or limited the rate of growth of spending in every area except major transfers to persons, Equalization payments, and Canada Assistance Plan payments to equalization-receiving provinces. Although the growth in total transfers to provinces was restrained, entitlements in cash and tax point transfers still grew on average faster than other federal program spending.

***Tough action on operating costs***

Operating costs were targeted for the toughest restraint in relative terms and have declined significantly in real terms. Managers effected the cuts by increasing efficiency and cutting waste. The operations of government were put on a more business-like basis. Greater cost recovery was undertaken in the areas of transportation services, inspection services, communications and publications. The government restrained public service salaries by freezing them in the first year of all new contracts in 1991 and limiting the second year increase to 3 per cent.

In the February 1991 budget, the government introduced the *Spending Control Act* and the Debt Servicing and Reduction Account. The *Spending Control Act* limits program spending for the period 1991-92 to 1995-96 to the levels projected in the February 1991 budget. Funds in the Debt Servicing and Reduction Account, to which are credited net GST revenues, net proceeds from privatization and gifts to the Crown, are earmarked to pay debt charges and ultimately pay down the national debt.

***Spending limits in law***

***Targeting GST to pay the debt***

Operating together, the *Spending Control Act* and the Debt Servicing and Reduction Account are key elements of the fiscal strategy to ensure that higher program spending cannot be funded by higher taxes.

Despite these rigourous measures, the recession pushed up the deficit because of substantially lower budgetary revenues and higher unemployment insurance benefits. The deficit increased to $30.6 billion in 1990-91 and to $34.6 billion in 1991-92.

## Outlook calls for additional restraint in program spending

### December 1992 Statement

Economic growth in 1992 was weaker than forecast, resulting in significantly lower government revenues. Forecast growth of 4¼ per cent a year over the medium term will not bring the economy to full capacity utilization by 1998. Combined with low and stable inflation, this outlook implies that government revenues will be much lower than projected in the February 1992 budget.

The December 1992 Statement represented an important step in addressing the deterioration in the fiscal situation. It provided for spending reductions amounting to almost $8 billion from 1992-93 to 1994-95. These measures focused on near-term fiscal pressures and spending control. Measures in the present budget reinforce those cuts by ensuring that the 1993-94 deficit target of $32.6 billion is met. They also extend the regime of spending restraint through 1997-98.

***December the first instalment***

## Extending and deepening the December cuts

*Building on December actions . . .*

This budget makes the spending reductions announced in the December 1992 Statement for 1993-94 and 1994-95 ongoing. In a number of areas, the reductions are deepened to ensure that the fiscal target for 1993-94 is met and that total program spending, on average over the period 1993-94 to 1997-98, will grow in line with the expected inflation rate of 1.6 per cent a year.

*. . . while exempting provinces*

The government will not impose any additional restraint measures on major federal transfers to provinces beyond those already set out in the Expenditure Control Plan, introduced in the February 1990 budget and extended in the 1991 budget (see section on Expenditure Plan below). The federal government is discussing with the provinces potential reforms to the major federal-provincial transfers (Equalization, Established Programs Financing and Canada Assistance Plan), not only to adapt them to economic and fiscal circumstances, but also to examine ways to make them meet the needs and priorities of Canadians more effectively.

*. . . seniors and veterans*

The extension and deepening of the Expenditure Control Plan does not apply to Old Age Security, the Guaranteed Income Supplement, Spouse's Allowances, War Veterans' Allowances and Veterans' Disability Pensions, or famine relief around the world. Transfer payments to the Territories, many native programs, special programs for the disabled, and the Canadian Jobs Strategy will also be exempt.

*$30.7 billion of actions*

The Expenditure Control Plan measures in this budget, in combination with those introduced in the December 1992 Statement, will yield savings of $3.8 billion in 1993-94, rising to $7.9 billion in 1997-98. Over the five-year period, 1993-94 to 1997-98, the cumulated savings will amount to $30.7 billion.

With these actions, program spending growth over the period 1993-94 to 1997-98 will average 1.7 per cent. Excluding major transfers to provinces, it will be held to only 1.5 per cent a year, slightly below the expected rate of inflation.

**Table 1**

*The Expenditure Control Plan – Direct fiscal impact of measures announced in December 1992 Statement and April 1993 Budget*

| | 1993-94 | 1994-95 | 1997-98 | Five-year savings |
|---|---|---|---|---|
| | | (millions of dollars) | | |
| **A. Reductions in grants and contributions** | | | | |
| Regional development funding | 204 | 230 | 415 | 1,420 |
| Transportation subsidies | 66 | 98 | 109 | 486 |
| Cultural subsidies | 33 | 33 | 66 | 246 |
| Other | 356 | 386 | 598 | 2,394 |
| Total | 659 | 747 | 1,188 | 4,546 |
| **B. Programs constrained** | | | | |
| Unemployment insurance benefits | | | | |
| Benefit rate | 550 | 1,000 | 1,000 | 4,550 |
| Voluntary quitters | 300 | 600 | 600 | 2,700 |
| Defence | 361 | 974 | 2,014 | 5,864 |
| International Assistance | 261 | 309 | 464 | 1,804 |
| Social housing | 8 | 59 | 227 | 600 |
| Granting councils | 39 | 73 | 166 | 550 |
| Total | 1,520 | 3,016 | 4,470 | 16,068 |
| **C. Reducing operating costs** | | | | |
| VIA Rail | – | – | 100 | 250 |
| Canadian Broadcasting Corporation | – | – | 100 | 250 |
| Departmental operating budget cuts | 998 | 1,217 | 2,072 | 7,531 |
| Total | 998 | 1,217 | 2,272 | 8,031 |
| **D. Total spending reductions** | **3,177** | **4,980** | **7,930** | **28,645** |
| **E. Other actions** | **625** | **800** | **–** | **2,025** |
| **F. Total deficit reductions** | **3,802** | **5,780** | **7,930** | **30,670** |

## Reductions in grants and contributions

The federal government spent about $13 billion in 1992-93 to provide social services to Indian and Inuit peoples, help stabilize and support farm incomes, encourage regional development, develop job skills, and support research and development. This assistance goes to individuals, businesses, associations and universities.

The December 1992 Statement reduced grants and contributions to most organizations and interest groups by 10 per cent in both 1993-94 and 1994-95. In addition, grants and contributions for a number of selected programs (certain native programs, granting councils, and grants in lieu of taxes) were frozen at their 1992-93 levels for two years.

### Extension and deepening of grant and contribution cuts

***Deepening the cuts to Gs&Cs***

In this budget, most of the grants and contributions to organizations and interest groups, which in the December 1992 Statement were reduced by 10 per cent in 1993-94 and 1994-95, are reduced by 15 per cent in 1995-96 and thereafter 20 per cent, from planned reference levels. These reductions reflect the need to make deficit reduction and expenditure restraint as broad as possible. The further reductions, however, will be applied equitably and over a reasonable period to give recipients time to adjust.

However, the government is willing to reallocate savings generated by the deepening of these cuts to western grain transportation, Atlantic transportation subsidies and the industrial milk subsidy to support reform efforts in these areas.

The federal government is committed to the reform of western grain transportation policies, by paying funds directly to producers through the *Farm Income Protection Act* and by improving the efficiency of the grain handling and transportation system. The government will continue to consult on the details of the reform package. Its intention is to implement the reform package by August 1, 1994.

The government will also examine ways to improve the effectiveness of the application of funds under the *Atlantic Region Freight Assistance Act* (ARFAA) and *Maritime Freight Rates Act* (MFRA). Consultations will be undertaken with industry and provincial governments.

All recognize that the dairy industry must undertake fundamental reforms to encourage growth in milk demand. The dairy industry itself initiated a consultation process in the fall of 1992 on possible reforms. The government is ready to support reform initiatives designed to develop markets, reduce costs and enhance competitiveness.

### Regional development funding

***Rationalizing regional spending***

The December 1992 Statement reduced funding for the regional development programs – the regional agencies (Atlantic Canada Opportunities Agency, Federal Office of Regional Development Quebec, and Western Economic Diversification), and several departments delivering federal-provincial regional and industrial development agreements – by 10 per cent in both 1993-94 and 1994-95. This reduction is now being extended.

Given the need for further fiscal savings, regional development funding is being reduced by an additional $90 million in 1993-94 and by $100 million a year thereafter. In the February 1990 budget, the government adopted a more businesslike approach to assistance to business, by instituting a policy requiring repayment of most contributions to business delivered by federal departments and agencies. The success of this policy will allow repayments to be returned to the departments and agencies which can then be used to make new repayable contributions. This will permit an additional reduction in direct funding from the government of $100 million in 1997-98. This initiative reinforces the government's efforts to orient its business assistance towards investing in economic development rather than the subsidization of the private sector.

The government will not be renewing the present federal-provincial agreements on economic and regional development in forestry and minerals, recognizing that these are essentially geared to areas of provincial jurisdiction and ones where provincial government and private sector activities have matured to the point where more limited federal government involvement is warranted. The government will be reviewing the economic and regional development agreements in other sectors as they expire. This includes economic and regional development agreements in agriculture, communications, environment, fisheries, transportation, industrial development, industrial innovation and tourism.

### Summary

In aggregate, the reductions in grants and contributions announced in the December 1992 Statement and extended and deepened in this budget will result in savings of $659 million in 1993-94 and $4.5 billion over the five-year period to 1997-98. Spending on these grants and contributions will be lower in 1997-98 than in 1992-93.

## Programs constrained

### Unemployment insurance benefits

The December 1992 Statement reduced the unemployment insurance benefit rate for new beneficiaries from 60 per cent to 57 per cent of average insurable earnings for two years beginning April 4, 1993. The unemployment insurance benefit rate will remain at 57 per cent beyond April 1995.

### Defence

The December 1992 Statement cut the operating budget for defence by 3 per cent for 1993-94 and 1994-95. It applied a two-year wage freeze to defence personnel. It reduced defence spending by a further $250 million in 1994-95. With these actions, defence spending was expected to grow by about 1.5 per cent in real terms, during the period 1993-94 to 1997-98.

***Defence spending cut by $5.9 billion***

The present budget freezes defence spending in real terms, beginning in 1994-95, generating substantial savings which grow over time. In combination with the December 1992 initiatives, savings amount to $361 million in 1993-94 and rise to $2.0 billion in 1997-98. Over the five-year period to 1997-98, cumulative savings are estimated at $5.9 billion. These reductions are in addition to cuts made in previous budgets.

The Department of National Defence will absorb these reductions by continuing to find savings through further reductions in the military and civilian work force and through slower growth in the reserves and capital spending. Military operations will be reduced. Existing peacekeeping commitments will be honoured. Modernization of capital remains a key component of the Forces' ability to fulfil their defence commitment.

### International assistance

The February 1991 budget introduced the International Assistance Envelope (IAE). It includes funding for both Official Development Assistance (ODA) and other international assistance initiatives, particularly in Eastern Europe and the former U.S.S.R. Growth in IAE was set at 3 per cent a year, beginning in 1992-93.

The December 1992 Statement reduced IAE grants and contributions, except those for famine relief, by 10 per cent in both 1993-94 and 1994-95.

Beginning in 1994-95, IAE will be constrained to growth of 1.5 per cent a year from the current base level, reflecting low inflation established since the February 1991 budget.

### University research councils

The government provided funding to the three university research councils – Natural Sciences and Engineering Research Council (NSERC), Medical Research Council (MRC), and Social Sciences and Humanities Research Council (SSHRC) – of about $770 million in 1992-93. The February 1992 budget set annual growth in grant funding at 4 per cent a year.

The December 1992 Statement froze grants and contributions to the councils at their 1992-93 levels for 1993-94 and 1994-95. Thereafter, the grants and contributions would again grow by 4 per cent a year.

With low inflation established, the annual rate of growth of grant funding to the councils is lowered to 1.5 per cent a year, after 1994-95. In the February 1992 budget, the government announced its intention to merge the Canada Council and SSHRC. Grant funding for the new agency, the Canada Council for Arts and for Research in Social Sciences and Humanities, will also grow at 1.5 per cent a year after 1994-95.

### Canada Mortgage and Housing Corporation

The government will not increase its support for social housing, through the Canada Mortgage and Housing Corporation (CMHC), beyond the current funding level of about $2 billion a year. CMHC will no longer fund housing through 35-year subsidy commitments which impose most of the costs of today's housing support on future taxpayers. Increased efficiencies in the financing and delivery of its programs will enable CMHC not only to maintain

its existing housing stock in good repair but also to provide some scope for new social housing commitments. Within this funding level, special purpose funding for shelters for victims of family violence, the National Strategy for the Integration of Persons with Disabilities and for native housing on reserves will continue.

## Reducing operating costs

The major focus of government spending restraint since 1984 has been reducing its operating costs. This has been directed at both Crown corporations and departmental and agency operating budgets.

### Crown corporations

Payments to Crown corporations were lower in 1992-93 than in 1984-85. Twenty-three Crown corporations have been or are in the process of being privatized, with another 16 dissolved. The Canada Post Corporation has been put on a self-sufficient basis. The heavy water plants in Cape Breton were closed, passenger rail services rationalized and subsidies to the Canadian Broadcasting Corporation scaled back.

In this budget, operating subsidies to VIA Rail and the Canadian Broadcasting Corporation will each be reduced by $50 million in 1995-96 and thereafter by $100 million a year.

### Departmental operating budgets

*Operating budgets cut . . .*

Operating costs totalled $18.2 billion in 1992-93. These costs include the operating and capital expenses associated with the programs directly delivered by the federal government such as food inspection, the Coast Guard, federal correctional services, provision of police services, tax collection, operation of airports and national parks, among others.

*. . . while improving efficiency*

There have been no inflation adjustments in operating budgets since 1986-87. In real terms, they have declined by 14 per cent over the period 1984-85 to 1992-93. As a proportion of total program spending, operating costs have declined from about 22.5 per cent in 1984-85 to about 15 per cent in 1992-93.

The constraints on operating budgets have meant changing how government does business. Available resources have been redirected to the point of service – where the client is – and away

from overhead and administrative processes. It has also meant getting out of some activities, consolidating others and eliminating duplication and overlap. Operating budgets – single expenditure budgets covering salaries, operations, maintenance and minor capital – have been established. They give managers flexibility in deciding how best to manage their resources in order to maximize results. They improve management efficiency, increase adaptability to changing client needs and increase accountability for the use of the tax dollar.

The February 1992 budget reduced non-wage operating budgets by a permanent 3 per cent from planned levels, beginning in 1992-93. Communication budgets were cut permanently by $75 million and strict travel guidelines were introduced. The December 1992 Statement reduced operating budgets for 1992-93 by an additional 2 per cent and thereafter by 5 per cent. Wage settlements, in the February 1991 budget, were frozen in the first year of all new contracts and restricted to 3 per cent in the second year. Salaries were frozen for an additional two years in the December 1992 Statement.

The government is making additional cuts to operating budgets. Departmental operating budgets, along with reserves for contingencies and new initiatives, will be reduced by an additional $300 million in both 1993-94 and 1994-95, rising to $1.2 billion in 1997-98. In combination with the December 1992 Statement wage strategy and operating budget reductions, total savings are estimated at $1.0 billion in 1993-94, rising to $2.1 billion in 1997-98. Over the five-year period to 1997-98, cumulative savings will amount to over $7.5 billion.

***Some offices will close***

These reductions will require federal departments and agencies to adjust priorities and reallocate funding from within approved budgets to accommodate most unanticipated changes in operational requirements. Reducing operating budgets will result in some reductions in government services. A number of point-of-service offices are being closed. Immigration offices are being reduced from 64 to 51, of which 22 are being co-located in Canada Employment Centres. External Affairs is in the process of closing nine missions and three embassies. The cuts to operating budgets will result in some disruptions to the public, although some of the impact will be lessened by efficiency improvements in the way services are delivered.

For managing the public service in the 1990s, the government needs new policies that promote a flexible and adaptable federal work force. Existing policies, including the Work Force Adjustment Directive, are inadequate and need to be updated. The government will therefore negotiate basic changes to the Work Force Adjustment Directive when it meets with the unions in the summer of 1993 for the scheduled triennial review.

## Streamlining government

In the February 1992 budget, the government announced measures to streamline government operations and improve service to the public. They included the elimination, wind-up or merger of 41 agencies and advisory boards and the consideration for privatization of an additional five, the co-location of services in urban centres, smarter and more cost-effective ways of delivering services, better use of information and technology, and review of federal regulatory programs.

### Twelve organizations merged or eliminated

This budget includes further streamlining measures. An additional 12 agencies, advisory boards and departments will be eliminated or merged. As well, a number of organizations are being considered for privatization or commercialization.

To reduce cost of compliance and provide for more efficient collections, legislation will be introduced to amalgamate the departments of Taxation and of Customs and Excise into a single Department of National Revenue. This will permit the completion of an administrative process begun some months ago. The National Advisory Council on Aging and the National Council of Welfare will be merged, with a mandate to advise the Minister of National Health and Welfare on issues that affect the social welfare of all Canadians.

### *Government streamlining*

**Wind up**

National Advisory Council on Physical Fitness and Amateur Sport
Canadian Environmental Assessment Research Council
National Marine Council
Atlantic Regional Council
Canadian Saltfish Corporation Advisory Board
Fisheries and Oceans Research Advisory Council
Oil and Gas Committee
Statute Revision Commission

**Merge**

National Advisory Council on Aging and the National Council of Welfare
Taxation and Customs and Excise

**Considerations for commercialization/privatization**

Canarctic Shipping Company Limited
Norman Wells oil project
Transport Canada's Helicopter Fleet Operations
Transport Canada's aircraft services
Transport Canada's flight inspection services
Geomatics – Special Operating Agency
Translation Bureau – Special Operating Agency

***Eight agencies eliminated***

***Four more merged***

## Considerations for privatization and commercialization

Since 1984, the government has privatized or dissolved 39 Crown corporations and other corporate interests, improved operations of the remainder. Productivity gains, privatization and rationalization have reduced the number of full-time Crown corporation employees by nearly 90,000.

In the coming fiscal year, the government will continue divesting itself of investments no longer required as instruments of public policy. It will examine the feasibility of divesting its interests in Canarctic Shipping Company Limited and the Northwest Wells oil project, the latter in consultation with affected aboriginal people in the Northwest Territories.

The government will also examine the potential advantages of devolving to the private sector a number of operational services, in order to reduce costs and raise efficiency. Transport Canada will launch an examination of benefits that could be derived by privatizing its helicopter fleet operations. A pilot project will be undertaken to use private sector resources in Transport Canada's western sector for flight inspection services, providing the technical accuracy and safety can be guaranteed. A comprehensive review will be undertaken of Transport Canada's fixed-wing aircraft services, to determine the most economic way to provide the service. The Secretary of State's Translation Bureau will be set up as a special operating agency. The same approach on a trial basis will be used in respect of Energy, Mines and Resources' surveys, mapping and remote sensing services – Geomatics.

### Modified quarterly instalment payments

*Improved targeting for tax instalments*

The basis for determining who is required to pay quarterly personal income tax instalments will be changed from proportion of income subject to withholding, to the amount of tax not withheld at source. Individuals will be required to make quarterly instalments if the amount of tax owing at filing time is greater than $2,000 in both the prior and current year. This change would exempt 300,000 filers, including many low-income seniors, from making quarterly instalments, and require 500,000 higher-income Canadians to file quarterly. This will result in a cash saving of $0.8 billion in 1994-95 and $0.6 billion in 1995-96, when the program will be fully implemented.

### Semi-annual payment of GST Credit

*Streamlining GST Credit*

The Goods and Services Tax Credit (GST Credit) is now paid in four instalments: January, April, July, and October. To reduce administrative costs and simplify operations, the GST Credit will be paid in two instalments: in April and October resulting in annual administrative savings of $7.5 million. The total amount of the GST Credit received by each eligible individual over the calendar year will remain the same. There will, however, be a one-time cash saving to the government of $625 million in 1993-94.

## Fiscal outlook

*Revenues weaker than expected . . .*

Tax revenues, especially from personal and corporate income taxes and the Goods and Services Tax, were substantially lower than projected in the February 1992 budget, owing to weaker-than-expected economic growth. In addition, cyclically sensitive components of program spending, unemployment insurance benefits and cash transfers under Established Programs Financing, increased more than expected. Interest rates declined during 1992, but were generally in line with the February 1992 budget expectations. Although the December 1992 Statement included measures to contain the fiscal slippage in 1992-93, revenues in the last few months of 1992-93 were weaker than expected. The deficit for 1992-93 is now estimated at $35.5 billion, $1.1 billion higher than the December 1992 Statement estimate.

*. . . as tax bases are down*

The downward revision of output in 1992, coupled with low inflation expected over the medium term, has resulted in substantially lower levels of nominal income, with accompanying downward revisions of the outlook for budgetary revenues. Nominal GDP in 1996 is expected to be about $70 billion lower than forecast in the February 1992 budget; nearly 60 per cent of that amount is attributable to lower inflation.

### Low inflation reduces spending with a lag

In contrast, given the structural changes introduced since 1984, program spending is only marginally sensitive to changes in inflation, as only a few programs are still indexed. The major fiscal saving from lower inflation comes from lower interest rates. The term structure of debt, however, means that the full impact of lower interest rates takes time to be felt. At the same time, the stock of debt increases owing to lower revenues, offsetting some of the gains from lower interest rates.

Table 2 presents the fiscal projections to 1997-98. They are based on the economic projections outlined in Chapter 2 and incorporate the impact of the measures introduced in this and previous budgets.

Table 2

*Summary statement of transactions: Budget 1993*

| | 1992-93 | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 |
|---|---|---|---|---|---|---|
| | | | (billions of dollars) | | | |
| Budgetary transactions | | | | | | |
| Budgetary revenues | 122.9 | 126.9 | 135.9 | 147.5 | 156.1 | 163.9 |
| Program spending | -118.9 | -120.0 | -123.1 | -126.2 | -127.6 | -128.6 |
| Operating balance | 4.0 | 6.9 | 12.8 | 21.4 | 28.5 | 35.2 |
| Public debt charges | -39.5 | -39.5 | -41.8 | -42.4 | -42.6 | -43.2 |
| Budgetary deficit | -35.5 | -32.6 | -29.0 | -21.0 | -14.0 | -8.0 |
| Non-budgetary transactions | 1.1 | 6.1 | 9.0 | 8.5 | 8.8 | 9.1 |
| Financial requirements (excluding foreign exchange) | -34.4 | -26.5 | -20.0 | -12.5 | -5.2 | 1.0 |
| Net public debt | 458.6 | 491.2 | 520.1 | 541.2 | 555.2 | 563.2 |
| Gross domestic product | 687.3 | 719.0 | 770.5 | 827.0 | 877.8 | 928.3 |
| | | | (percentage of GDP) | | | |
| Budgetary revenues | 17.9 | 17.7 | 17.6 | 17.8 | 17.8 | 17.7 |
| Program spending | -17.3 | -16.7 | -16.0 | -15.3 | -14.5 | -13.9 |
| Operating balance | 0.6 | 1.0 | 1.7 | 2.6 | 3.3 | 3.8 |
| Public debt charges | -5.7 | -5.5 | -5.4 | -5.1 | -4.8 | -4.7 |
| Budgetary expenditures | -23.0 | -22.2 | -21.4 | -20.4 | -19.4 | -18.5 |
| Deficit | -5.2 | -4.5 | -3.8 | -2.5 | -1.6 | -0.9 |
| Financial requirements | -5.0 | -3.7 | -2.6 | -1.5 | -0.6 | 0.1 |
| Net public debt | 66.7 | 68.3 | 67.5 | 65.4 | 63.2 | 60.7 |

(-) Indicates a net requirement for funds.
(+) Indicates a source of funds.

## No change in 1993-94 deficit

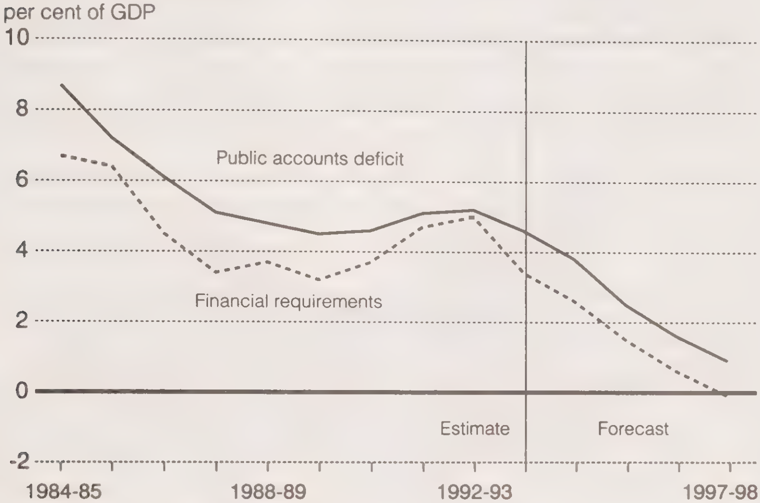
The additional actions in this budget will make it possible to keep the deficit for 1993-94 to $32.6 billion projected in the December 1992 Statement.

## Deficit falls over outlook period

The deficit declines to $29 billion in 1994-95 and to $8 billion by 1997-98. As a proportion of GDP, the deficit declines from 5.2 per cent in 1992-93 to 0.9 per cent in 1997-98.

**Chart 5**

*The budgetary deficit and financial requirements*[1]




[1] Excluding foreign exchange transactions.

## Surplus financial requirements by 1997-98

***No new borrowings by 1997-98***

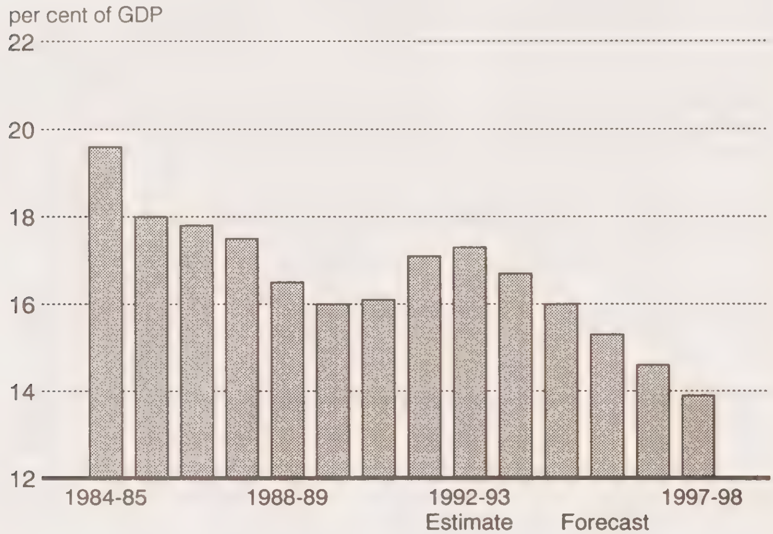
Financial requirements excluding foreign exchange requirements, a comprehensive measure of the government's borrowing in credit markets, fall from $34.4 billion in 1992-93 to $26.5 billion in 1993-94. Financial requirements will be in surplus in 1997-98. This means the government will begin to pay down its outstanding stock of debt. (Chart 5)

## Zero real growth in program spending

***Spending lowest in over 30 years***

The annual average rate of growth in program spending is constrained to 1.7 per cent over the period 1993-94 to 1997-98. As a percentage of GDP, program spending declines from a postwar peak of 19.6 per cent in 1984-85, to 17.3 per cent in 1992-93 and 13.9 per cent in 1997-98. This will be the lowest level in over 30 years. (Chart 6)

**Chart 6**
*Program expenditures*
*1984-85 to 1997-98*




### Public debt declines as a proportion of output

As a proportion of GDP, public debt peaks at 68.3 per cent in 1993-94 and declines steadily thereafter to reach 60.7 per cent in 1997-98.

## The Expenditure Plan

Total budgetary expenditures are expected to increase at an annual average rate of 1.9 per cent over the five-year period 1993-94 to 1997-98. Program spending is expected to increase by an average 1.7 per cent while public debt charges increase by 2.1 per cent.

### Growth in elderly benefits and transfers to provinces

Over the next five years, elderly benefits and entitlements under the major transfers to provinces increase at an annual average rate nearly two-and-a-quarter times faster than the growth in total program spending.

***Transfers to provinces and seniors fastest growing***

The Expenditure Control Plan restrained the growth in per capita entitlements to provinces under Established Programs Financing entitlements to the end of 1994-95. Thereafter, growth in per capita entitlements will resume at the rate of growth in GNP less three percentage points. Canada Assistance Plan transfers to the non-equalization-receiving provinces were capped at 5 per cent annual growth to 1994-95. Thereafter, as noted in the February 1991 budget, these transfers are assumed, for planning purposes, to grow roughly in line with increases in GNP, pending continuing discussions with the provinces to reform social program financing.

Old age security benefits and cash transfers to provinces account for about 40 per cent of total program spending. Excluding these programs, spending on other programs increases by an average of only 0.7 per cent a year, well below the expected rate of inflation over this period. This low rate of increase in spending is due primarily to the impact of actions taken in this and previous budgets. These reductions structurally lower program spending to bring it in line with the outlook for inflation.

### Spending in 1992-93 unchanged from December Statement

Program spending for 1992-93 is estimated at $118.9 billion, unchanged from the estimate in the December 1992 Statement. Nevertheless, spending is estimated to have increased by 3 per cent between 1991-92 and 1992-93. Most of this increase was attributable to higher unemployment insurance benefits, increased old age security benefits and higher transfers to provinces. The increase in unemployment insurance benefits reflected higher average benefits and continuing high levels of unemployment following the 1990-1991 recession. The aging of the population, coupled with full indexation of benefits, which in 1991-92 included the impact of the one-time price impact of replacing the manufacturers' sales tax by the GST, contributed to the increase in old age security benefits. Prior-year adjustments, due to data revisions, account for most of the increase in transfers to provinces, especially for Established Programs Financing. Growth in all other components was restrained during 1992-93, in large part reflecting the impact of the restraint measures in the February 1992 budget and December 1992 Statement.

### Spending in 1993-94 below December 1992 Statement

The restraint measures in this budget, coupled with somewhat lower than expected spending on old age security and unemployment insurance benefits, will make program spending $0.9 billion lower in 1993-94 than estimated in the December 1992 Statement.

Program spending is expected to increase by only 0.9 per cent in 1993-94, reflecting the impact of the restraint measures and the restructuring of the child benefit system. The monthly Child Tax Benefit came into effect January 1993. It represents a reduction in income taxes that would otherwise be payable and is set off against personal income tax revenues rather than being included as part of program spending. A one-time adjustment in 1992-93 to the government's liability for employee pensions due to the effect of the two-year wage freeze distorts the year-to-year change in government operations. The restraint measures in the December 1992 Statement, coupled with the measures announced in this budget, lowered program spending by $3.2 billion in 1993-94.

### Spending in 1994-95 below February 1992 budget

Program spending in 1994-95 is projected to be $1 billion lower than forecast in the February 1992 budget. The measures contained in this budget and the December 1992 Statement lower the planned level of program spending by $5 billion in 1994-95. However, program spending is still forecast to increase by $3.1 billion between 1993-94 and 1994-95. Most of this increase is attributable to higher old age security benefits (up $1.0 billion, due to the indexation of benefits and increases in the number of recipients), increased unemployment insurance benefits (up $0.5 billion, primarily reflecting increases in average benefits) and higher transfers to provinces (up $0.5 billion). The increases in reserves net of lapse reflects the reduction made in 1993-94 to the reserves.

The annual changes in public debt charges reflect the impact of higher annual borrowing requirements, dampened by the impact of the lower interest rates as issues mature and are renewed at the lower rates.

**Table 3**
*Budgetary expenditures*

| | 1992-93 | 1993-94 | 1994-95 | 1997-98 | Annual average change 1993-94 to 1997-98 |
|---|---|---|---|---|---|
| | | (billions of dollars) | | | (per cent) |
| A. Major transfers to persons | 42.1 | 41.0 | 42.6 | 43.7 | 1.6 |
| of which: | | | | | |
| Old age security | 19.1 | 20.0 | 21.0 | 23.7 | 4.3 |
| Unemployment insurance benefits | 19.2 | 19.4 | 19.9 | 18.2 | -1.5 |
| Family allowances | 2.2 | –[1] | – | – | – |
| B. Major transfers to other levels of government [2] | 26.9 | 26.4 | 26.8 | 29.2 | 2.6 |
| C. Major subsidies/ other transfers | 13.1 | 13.3 | 13.0 | 12.9 | -0.8 |
| of which: | | | | | |
| Subsidies to business | 3.1 | 3.3 | 3.1 | 2.5 | -6.5 |
| Native programs[3] | 3.3 | 3.6 | 3.8 | 4.5 | 5.6 |
| Agricultural subsidies | 2.7 | 2.4 | 2.3 | 2.2 | -2.1 |
| Other | 4.0 | 4.1 | 3.9 | 3.8 | -1.9 |
| D. Payments to major Crown corporations | 4.7 | 4.7 | 4.6 | 4.5 | -1.1 |
| of which: | | | | | |
| CMHC | 2.1 | 2.1 | 2.1 | 2.2 | 1.1 |
| CBC | 1.1 | 1.1 | 1.1 | 1.0 | -1.3 |
| E. Defence | 11.2 | 11.3 | 11.5 | 12.0 | 1.6 |
| F. International Assistance | 2.8 | 2.7 | 2.7 | 2.9 | 1.5 |
| G. Reserves net of lapse | – | 0.3 | 1.1 | 1.9 | – |
| H. Government operations | 18.2 | 20.3 | 20.6 | 21.5 | 1.4 |
| I. Program spending | 118.9 | 120.0 | 123.1 | 128.6 | 1.7 |
| J. Public debt charges | 39.5 | 39.5 | 41.8 | 43.2 | 2.1 |
| K. Total budgetary expenditures | 158.4 | 159.5 | 164.8 | 171.8 | 1.9 |

[1] Family allowances have been merged into a new Child Tax Benefit, which is netted against personal income tax collections.

[2] Certain transfers to other levels of government are made as a combination of cash and a transfer of tax points. Total transfers to provinces, including cash and tax transfers but excluding prior-year adjustments, are as follows:

| | | | | | |
|---|---|---|---|---|---|
| Cash and tax transfers to other levels of government | 39.2 | 40.4 | 41.7 | 46.7 | 3.7 |

[3] Total native spending, including transfers to territories, spending by CMHC and other government departments, is estimated at $5.4 billion in 1993-94.

## The Spending Control Act

***Spending limits set in law***

The *Spending Control Act* received royal assent on June 18, 1992. Legislated spending limits ensure that program spending over the period 1991-92 to 1995-96 cannot, except in a limited set of prescribed circumstances, exceed the projections in the 1991 budget. The *Spending Control Act* covers all program spending, comprised of total spending less public debt charges, with the exception of expenditures relating to a limited number of self-financing programs: unemployment insurance, Gross Revenue Insurance Plan, the Agricultural Commodities Stabilization Accounts, and the Crop Re-insurance Fund, and spending relating to developments before 1991-92. The spending limits are to be adjusted on an annual basis for spending related to good management initiatives that lower the deficit.

The *Spending Control Act* pulls together a variety of spending control mechanisms introduced by the Expenditure Control Plan and makes spending control more visible and easier for the public to understand. If expenditure on a program rose above the projection for economic or policy reasons, it would have to be offset by reductions elsewhere: the *Spending Control Act* would not allow increased borrowing or increased taxes to fund spending higher than planned.

The spending control limits as set out in the current legislation and adjusted for good management exemptions, as permitted under section 4(1) of the *Spending Control Act* and certified by the President of Treasury Board in the Supplementary Estimates (A) for 1992-93, are presented in Table 4.

The government has implemented two important measures which change the structure of spending. The restructuring of the child benefit system replaced family allowances with the Child Tax Benefit. As the Child Tax Benefit represents a reduction in personal income taxes and is administered through the *Income Tax Act*, it is netted against personal income tax revenues and not included as part of program spending. Parliament has also enacted legislation that makes public sector pension plans fully funded. The government no longer has to make separate payments to cover shortfalls in indexation costs.

***Reducing the limits means real control***

In the February 1992 budget, the government indicated that once legislation to restructure the child benefit system and full funding of pensions was passed, the spending control limits would be lowered accordingly.

This would lower the spending limit for 1992-93 by $1.7 billion from the current limit, and by about $3.5 billion each year from 1993-94 to 1995-96. Actual spending subject to control in 1991-92, as audited by the Auditor General of Canada, was $1.4 billion below the spending control limit for that year. With the spending reduction measures taken in the February 1992 budget and the December 1992 Statement, spending subject to control for 1992-93 is estimated to be $0.9 billion below the adjusted limit.

**Table 4**
*April 1993 budget*
*Compliance with the Spending Control Act*

| | 1991-92 | 1992-93 | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 |
|---|---|---|---|---|---|---|---|
| | | | (billions of dollars) | | | | |
| **A. Spending Control Act** | | | | | | | |
| 1. February 1991 budget projects | 115.8 | 119.7 | 122.8 | 126.5 | 130.6 | – | – |
| 2. Less self-financing programs | -18.6 | -18.8 | -18.7 | -19.1 | -19.4 | – | – |
| 3. Exemptions pursuant to section 4(1) | – | 0.1 | 0.1 | 0.1 | 0.1 | – | – |
| 4. Spending limits | 97.2 | 101.0 | 104.2 | 107.5 | 111.3 | – | – |
| **B. Adjustments for restructuring of child benefit system/ full funding of pensions** | – | -1.7 | -3.7 | -3.6 | -3.5 | – | – |
| **C. Adjusted spending limits** | 97.2 | 99.3 | 100.4 | 103.8 | 107.8 | – | – |
| **D. April 1993 budget** | | | | | | | |
| 1. Program spending | 115.4 | 118.9 | 120.0 | 123.1 | 126.2 | 127.6 | 128.7 |
| 2. Less self-financing programs | -19.4 | -20.5 | -20.7 | -21.3 | -21.4 | -21.0 | -19.5 |
| 3. Expenditures related to events occurring prior to April 1991 | -0.2 | – | – | – | – | – | – |
| 4. Program spending subject to control | 95.8 | 98.4 | 99.3 | 101.8 | 104.8 | 106.6 | 109.2 |
| **E. Under (-)/Over(+) spending** | **-1.4** | **-0.9** | **-1.2** | **-2.0** | **-3.0** | **–** | **–** |
| **F. Proposed spending limits** | **97.2** | **99.3** | **99.3** | **101.8** | **104.8** | **106.6** | **109.2** |

With the further actions in this budget, spending will again be below the adjusted limits by increasing amounts through the remaining three years of the *Spending Control Act*. Over the period 1991-92 to 1995-96, spending subject to control is projected to be a cumulative $8.5 billion below the limits set out in the *Spending Control Act*, adjusted for the restructuring of the child benefit system and the full funding of pensions.

This budget, therefore, satisfies the requirements of the *Spending Control Act*.

The government proposes that the spending control limits be lowered further to conform to the spending projections contained in this budget as well as extending these limits to 1997-98. Legislation will be introduced to effect these changes. The proposed spending limits are shown in Table 4.

## The revenue outlook

The projections in Table 5 show the revenue outlook to 1997-98. They are based on the economic outlook presented in Chapter 2 and incorporate the cash management and prosperity-related tax initiatives announced in this budget.

***Revenues grow with economy***

The modest growth in nominal incomes has dampened the various tax bases underlying federal government revenues. Revenue growth in 1993-94 is further dampened by the netting of the new Child Tax Benefit against personal income tax collections. Over the period 1993-94 to 1997-98, the growth in budgetary revenues is broadly consistent with the growth in nominal GDP.

**Table 5**
*Budgetary revenues*

| | 1992-93 | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 |
|---|---|---|---|---|---|---|
| | | | (billions of dollars) | | | |
| Personal income tax | 58.7 | 58.1 | 63.7 | 70.0 | 74.0 | 80.5 |
| Corporate income tax | 8.5 | 9.7 | 11.8 | 14.4 | 16.0 | 16.7 |
| Unemployment insurance contributions | 17.5 | 19.0 | 20.5 | 22.4 | 24.3 | 23.6 |
| Goods and Service Tax | 15.3 | 17.4 | 18.1 | 19.3 | 20.3 | 21.5 |
| Excise taxes and duties | 11.8 | 12.1 | 12.3 | 12.4 | 12.5 | 12.7 |
| Other revenues | 11.1 | 10.6 | 9.5 | 9.0 | 9.0 | 8.8 |
| Budgetary revenues | 122.9 | 126.9 | 135.9 | 147.5 | 156.1 | 163.9 |

The downward revision to output in 1992, coupled with low inflation expectations over the medium term, has resulted in substantially lower levels of nominal income and lowering of the outlook for budgetary revenues. Nominal GDP in 1996 is expected to be about $70 billion lower than forecast in the February 1992 budget, nearly 60 per cent of that amount is attributable to lower inflation.

As a result, budgetary revenues of $122.9 billion in 1992-93 are $9.2 billion lower than projected in the February 1992 budget, and about $10 to $12 billion lower in later fiscal years.

## Debt Servicing and Reduction Account

***GST goes to deficit and debt reduction***

To ensure that GST revenues are used to pay the interest on the public debt and ultimately to reduce the public debt, the government has established, through legislation, the Debt Servicing and Reduction Account. Net revenues collected from the GST, gifts to the Crown earmarked to debt reduction, and the proceeds from privatization must, by law, go directly to the Debt Servicing and Reduction Account. The Account is audited annually by the Auditor General of Canada. Table 6 sets out the flows in the Account for fiscal years 1991-92 and 1992-93.

**Table 6**
*Debt Servicing and Reduction Account*

| | 1991-92 | 1992-93 |
|---|---|---|
| | (millions of dollars) | |
| Net GST revenues | 15,168.5 | 15,300 |
| Gains on disposals of shares or interests in Crown corporations | 2.5 | – |
| Gifts to the Crown | 0.4 | – |
| Net receipts | 15,171.4 | 15,300 |

The Debt Servicing and Reduction Account, in conjunction with the legislated spending caps, ensures that GST revenues will go to deficit and debt reduction, not new program spending.

## Factors affecting financial requirements

The government's net financial requirements consist of non-budgetary, as well as budgetary transactions. These include loans, investments and advances, government employees'

pension accounts, other specified-purpose accounts, interest and debt accounts, and other non-budgetary transactions. Total non-budgetary transactions have normally provided the government with a net source of funds, lessening its dependence on financial markets.

The principle underlying the distinction between budgetary and non-budgetary transactions is that transactions changing the net indebtedness of the government are classified as budgetary, and those involving the receipt of offsetting financial assets or the creation of liabilities are classified as non-budgetary. In addition, the government maintains a number of trust accounts held for third parties, such as pension accounts of federal government employees. Other non-budgetary transactions include accounting adjustments to certain budgetary transactions that are recorded on an accrual basis to a cash basis. These include interest accounts, accounts payable, cash-in-transit, and outstanding cheques.

Non-budgetary transactions are estimated at only $1.1 billion in 1992-93. The low net source of funds in that year was due to loans to the Canada Deposit Insurance Corporation and adjustments to the Provincial Tax Collections Agreements Account for overpayments to the Account in previous fiscal years. Thereafter, the net source of funds from non-budgetary transactions is forecast at more traditional levels.

**Table 7**
*Non-budgetary transactions*

| | 1992-93 | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 |
|---|---|---|---|---|---|---|
| | | | (billions of dollars) | | | |
| Loans, investments, and advances | -1.8 | 0.3 | 0.5 | 0.3 | 0.3 | 0.3 |
| Specified purpose accounts | 5.1 | 5.5 | 7.3 | 7.6 | 7.9 | 8.1 |
| Other transactions | -2.2 | 0.3 | 1.2 | 0.7 | 0.7 | 0.7 |
| Non-budgetary transactions | 1.1 | 6.1 | 9.0 | 8.5 | 8.8 | 9.1 |

Note: Figures may not add due to rounding.

## Financial requirements and borrowing authority

The amount of borrowing authority requested from Parliament for a fiscal year has traditionally been tied to the financial requirements forecast for that year. The actual level of borrowing is also influenced by foreign exchange transactions that cannot be forecast in advance.

The government has introduced legislation seeking borrowing authority of $31.5 billion for 1993-94 to cover financial requirements of $26.5 billion, expected Exchange Fund earnings of $2 billion, and a contingency of $3 billion to manage foreign exchange transactions (Table 8). Borrowing authority to cover Exchange Fund earnings is requested because these earnings, although reported as budgetary revenues, remain in the Exchange Fund Account and are not available to finance ongoing operations of government.

**Table 8**
*Borrowing requirements*

| | 1993-94 |
|---|---|
| | (billions of dollars) |
| Financial requirements (excluding foreign exchange requirements) | 26.5 |
| Exchange fund earnings | 2.0 |
| Reserve for contingencies | 3.0 |
| Total borrowing authority requested | 31.5 |

# Chapter 4: Supplementary Information

## Investing in prosperity

The last several years have seen important changes to the tax system to improve the performance of the Canadian economy. These changes began with the major reforms of the income and sales tax systems, and continued with adjustments made to the taxation of manufacturing and processing and research and development (R&D) in the February 1992 budget and the December 1992 Economic and Fiscal Statement.

In the December 1992 Economic and Fiscal Statement, the government identified three further areas where changes to the tax system could contribute to prosperity in the increasingly competitive world economy. The areas identified for review were:

- the treatment of rapidly depreciating equipment;
- the ability of Canadian firms to access new technology; and
- impediments to the growth of small innovative firms.

At that time, it was indicated that $400 million would be set aside over the next five years to facilitate improvements in these areas. On the basis of consultations with businesses to determine priorities and possible solutions, the government is proposing the following changes.

### *Rapidly depreciating equipment*

For the purposes of the *Income Tax Act*, deductions for depreciation of capital property are provided through the capital cost allowance (CCA) system. In general, the CCA system operates in a straightforward manner by grouping properties into a limited number of broad classes with specified write-off rates.

In most cases, this system works well, providing, on average, deductions for tax purposes that reflect the useful life of the property. However, the rate at which any particular piece of equipment depreciates can vary significantly depending on how it is used and the progress of technological change. Consultations with interested businesses and associations have revealed that, in some circumstances, the CCA system does not adequately reflect variations in depreciation experience resulting from technological change. Certain types of equipment can become obsolete before being fully depreciated for income tax purposes.

The most frequently identified equipment for which such variation in depreciation was a concern was computer equipment and certain types of office communication and electronic equipment.

In response to these concerns, it is proposed that the *Income Tax Regulations* be amended to enable taxpayers to elect to place eligible property in a separate class for CCA purposes. Eligible property will include general-purpose electronic data processing equipment, photocopiers, and certain electronic communications equipment that would otherwise be included in Class 8 of Schedule II to the *Income Tax Regulations*, such as facsimile transmission devices and telephone and related ancillary equipment where the cost for each such eligible property is $1,000 or more.

A separate class election does not change the specified CCA rate on the equipment. Rather, it allows a taxpayer to calculate a separate CCA deduction with respect to one or more particular pieces of equipment included in the separate class. The separate class election ensures that, on the disposition of all the property in the class, any remaining undepreciated cost of the equipment may be fully deductible as a terminal loss. The election will benefit taxpayers who acquire eligible equipment that depreciates more rapidly than that implicit in the CCA rate for property of that class.

To simplify the operation of this elective mechanism, a special rule is being established. It will require the undepreciated capital cost (UCC) in each separate class, created pursuant to this measure, that is remaining after five years, to be transferred into the UCC pool of the corresponding class.

This measure will be effective for property acquired after April 26, 1993. The proposed election must be made in the income tax return for the taxation year in which the property was acquired.

## Accessing technology

New technology is being rapidly developed and integrated into production and distribution systems. It is important for Canadian businesses to acquire new technologies in order to maintain their ability to compete in the global marketplace. An issue identified in the December 1992 Economic and Fiscal Statement was whether

the tax system is impeding the ability of Canadian firms to access these new technologies. As a result of consultations, two modifications to the tax system are proposed:

- the introduction of a new capital cost allowance (CCA) rate and write-off method for the acquisition of patents and rights to use patented information; and
- the elimination of the non-resident withholding tax on arm's length payments in respect of rights to use patented information.

## *New CCA rate for patents*

One of the important ways in which Canadian businesses access new technologies is by acquiring patents or licences to use patents for new products or processes. An important factor that affects the after-tax cost of these patents or licences is the rate at which they are depreciated for tax purposes.

Currently, patents and licences of a fixed period are written off on a straight-line basis over the life of the patent or licence. Licences of an indeterminate period are considered eligible capital property, three-fourths of the costs of which may be written off on a 7 per cent declining balance basis.

The government proposes to introduce a new 25 per cent declining balance capital cost allowance (CCA) class for all patents and rights to use patented information acquired after April 26, 1993.

A 25 per cent declining balance CCA rate will generally provide larger deductions in the earlier years of a patent's use. This rate recognizes that the value of a patent often declines faster in its earlier years as new technologies are developed.

Taxpayers will be allowed the option of using the existing system. This could be advantageous in cases where a patent is acquired late in its life.

### *Withholding taxes on payments for the use of patents*

When Canadian businesses acquire rights to use new technologies from non-residents, the payments for these rights are subject to withholding tax. The *Income Tax Act* currently imposes a non-resident withholding tax of 25 per cent on these payments. This rate is generally reduced in bilateral income tax treaties and is currently 10 per cent on such payments made by Canadian taxpayers to residents of most industrialized countries.

The Canadian government is prepared, in its tax treaty negotiations, to eliminate the withholding tax on arm's length payments in respect of rights to use patented information or information concerning scientific experience.

The government also affirms its commitment to negotiate, on a bilateral basis, exemptions from withholding taxes for payments made for the use of computer software. Canada recently concluded a protocol to the Canada-Netherlands Income Tax Convention which provides for such an exemption.

Eliminating the withholding tax on these payments will reduce the cost to Canadian firms of accessing technology developed by foreign firms. As any such exemption will be negotiated on a bilateral basis, it will also make it more attractive for Canadian firms to export technology they have developed. These factors should enhance the ability of Canadian firms to keep pace with innovative developments abroad and should expand the overseas market for Canadian technology.

## Impediments to the growth of small innovative firms

The income tax system provides several incentives that are targeted at smaller, typically start-up companies. For example, the system of tax incentives for research and development provides larger benefits and increased refundability for qualifying small businesses. These incentives are targeted to small companies in order to reflect the relatively greater financing and cash flow difficulties faced by these companies.

One inevitable result of this targeting is that as smaller firms begin to prosper and grow in size, they can lose access to some, or all, of these incentives. Consultations revealed that in certain

circumstances the loss of these incentives is very abrupt and can act as a serious impediment to a firm's growth.

To address these concerns, two changes to the existing rules are being proposed:

- extension of the enhanced R&D tax benefits to small expanding businesses; and
- elimination of the annual limit on claiming investment tax credits.

## *Extending enhanced R&D tax benefits*

Qualifying small companies receive enriched benefits under the Scientific Research and Experimental Development (SR&ED) Program. These benefits include a 35 per cent investment tax credit on the first $2 million of qualifying SR&ED expenditures.This credit is 100 per cent refundable for current SR&ED expenditures and 40 per cent refundable for capital expenditures.

For a small business to qualify for enriched SR&ED benefits, it must be a Canadian-controlled private corporation (CCPC) throughout its taxation year, and its taxable income for the preceding taxation year (including the taxable income of all associated corporations), must not have exceeded the small business limit of $200,000. If taxable income exceeded $200,000 in the preceding year, none of its SR&ED expenditures are eligible for the enriched benefits. That is, the tax credit rate on its first $2 million of eligible expenditures is reduced from 35 per cent to 30 per cent for SR&ED performed in the Atlantic provinces and Gaspé Peninsula and from 35 per cent to 20 per cent for SR&ED performed elsewhere in Canada, and the credits on these expenditures are no longer refundable.

These rules have a negative impact for businesses that grow beyond the initial start-up phase. Exceeding the small business limit can adversely affect the taxpayer's cash flow since all refundability of investment tax credits is forfeited for the following year. Furthermore, the relatively large financial impact associated with losing access to these benefits, can create significant uncertainties for taxpayers with taxable income near the $200,000 threshold.

After having consulted with both taxpayers and industry associations, it is proposed that the existing $2 million SR&ED expenditure limit for enriched benefits be phased out between taxable incomes of $200,000 and $400,000, rather than terminated at $200,000.

Under this proposal, for each dollar by which taxable income for a year exceeds $200,000, the SR&ED expenditure limit for the year ($2 million – the maximum expenditure eligible for the 35 per cent high-rate credit) will be reduced by $10. Therefore, at $400,000 of taxable income for the prior year, none of the expenditures will be eligible for these enhanced benefits. These new rules will be effective for SR&ED expenditures incurred in taxation years beginning after 1993.

Extending the enhanced SR&ED benefits will reduce the negative tax consequences of exceeding the $200,000 small business limit by a small amount. It will ease the transition between the start-up phase and the period of expansion that small businesses typically experience, thereby providing more certainty to their business planning.

A comparison of the existing system and the proposed system for a taxpayer with $2 million of current SR&ED expenses is provided below. Under the proposed rules, the total credit earned declines from $700,000 (35 per cent of $2 million) to $400,000 (20 per cent of $2 million) gradually between taxable income of $200,000 and $400,000, rather than immediately when income exceeds $200,000. Similarly, under the proposal the maximum refundable ITC does not go to zero for taxable income in excess of $200,000, but instead declines gradually between taxable incomes of $200,000 and $400,000.

*Extending enhanced SR&ED benefits:*
*Comparison of existing and proposed rules*

| Taxable income | Total credit[1] earned | | Maximum refundable ITC | |
|---|---|---|---|---|
| | Existing | Proposed | Existing | Proposed |
| | (in dollars) | | | |
| 200,000 | 700,000 | 700,000 | 700,000 | 700,000 |
| 250,000 | 400,000[2] | 625,000 | NIL | 525,000 |
| 300,000 | 400,000 | 550,000 | NIL | 350,000 |
| 350,000 | 400,000 | 475,000 | NIL | 175,000 |
| 400,000 | 400,000 | 400,000 | NIL | NIL |

[1] Assumes SR&ED current expenses of $2 million.

[2] Assumes ITC rate of 20 per cent.

## ■ *Eliminating the annual limit on claiming investment tax credits (ITCs)*

The tax reform measures of 1987 introduced a limitation on the amount of ITCs that could be utilized in a taxation year. This limitation was introduced to reduce the number of large corporations that were profitable, but did not pay income tax. However, the large corporations tax (LCT), which was introduced in 1989, now ensures that all large corporations contribute to reducing the deficit and has, therefore, eliminated the need for the annual ITC limitation.

Furthermore, consultations have indicated that the existing annual limitation on ITC claims significantly reduces the effectiveness of these investment incentives for rapidly growing firms. Removing the claim limitation will enhance the incentives for regional projects and investment in SR&ED.

Effective for taxation years beginning after 1993, the existing annual limit on ITC claims will be eliminated, allowing taxpayers to fully claim their ITCs against federal Part I tax otherwise payable. This change will apply to ITCs previously earned but not yet claimed as well as ITCs earned after April 26, 1993.

*Revenue impact of measures*

| | 1993-94 | 1994-95 | 1995-96 | 1996-97 | 1997-98 | Five-year total |
|---|---|---|---|---|---|---|
| | | | (millions of dollars) | | | |
| Separate class election | 0 | 3 | 5 | 12 | 20 | 40 |
| New CCA rate for patents | small | 5 | 10 | 15 | 20 | 50 |
| Changes to withholding taxes | 5 | 25 | 25 | 30 | 30 | 115 |
| Extension of SR&ED benefits | 2 | 11 | 12 | 12 | 13 | 50 |
| Eliminating ITC limitation | 10 | 40 | 35 | 30 | 25 | 140 |
| Total | 17 | 84 | 87 | 99 | 108 | 395 |

## Other measures

Two other tax measures are proposed. They affect quarterly income tax instalments and the delivery of the GST Credit payments.

### ■ *Modification to quarterly income tax instalments*

In order to simplify the quarterly instalment system and improve its targeting, it is proposed that the basis for determining who is required to make quarterly income tax instalments be changed from the proportion of income not subject to withholding to the amount of tax not withheld at source.

Currently, an individual must remit quarterly income tax instalments for the year if the following three conditions all apply:

- prior-year federal tax liability was greater than $1,000;
- current-year federal tax liability will be greater than $1,000;
- less than three-quarters of current-year net income is subject to withholding at source.

Under this system, a significant number of low-income individuals are required to remit instalments, even though they have relatively small tax liabilities. On the other hand, a number of higher-income individuals owing large amounts of tax are not required to remit instalments.

The budget proposes that the current three conditions which determine who is required to make instalments be replaced by one simple rule:

*An individual will be required to make quarterly payments if the difference between tax payable and amounts withheld at source is greater than $2,000 in both the current year and either of the two preceding years.*

For this purpose, the tax payable includes the combined federal and provincial income tax. Since the federal government only collects its portion of income taxes in Quebec, the $2,000 amount will be adjusted for Quebec residents to $1,200 of federal tax payable after federal tax withholdings. The proposed system will become effective for the September 15, 1994 instalment.

This modification will mean that 300,000 individuals, who currently must make small quarterly payments of less than $2,000 per year, will no longer be required to make instalments. Many of these are seniors and low-income tax filers. It will also require approximately 500,000 additional higher-income taxpayers to make quarterly instalments.

As a transition measure, to alleviate the cash-flow needs of first-time instalment remitters as a result of these new rules, the September and December 1994 instalments will only have to cover a maximum of one-half of the year's total instalment liability, rather than the full amount.

Revenue Canada will continue to notify individuals required to remit instalments of the amount of each instalment determined on the basis of tax information from prior years. The options for determining the amount of instalments will not be changed.

Another change also applies to self-employed individuals whose chief source of income is farming or fishing. These individuals are subject to special instalment rules and are only required to make one instalment, in December. Under the new system, they will only be required to make this instalment if the difference between tax payable and amounts withheld at source is greater than $2,000 in all three of the current and the two preceding years. This change will also remove many low-income filers from the instalment system.

## ■ *Streamlining GST Credit payments*

This budget proposes that the Goods and Services Tax (GST) Credit be paid semi-annually instead of quarterly in order to simplify the operation of this program. This will mean that 16 million fewer cheques will be processed each year.

Beginning in 1994, the GST Credit will be paid in April and October. The new April payment will combine the January and April quarterly payments. The new October payment will combine the July and October quarterly payments.

The total amount of GST Credit for which an individual is eligible will not change. For example, a family with two children and net income of $25,000 in 1992 will receive one cheque of $304 in April 1994 instead of a cheque of $152 in each of January and April 1994. Similarly, the new October 1994 GST Credit payment will combine the July and October 1994 quarterly payments.

# Chapter 5: Draft Capital Cost Allowance Regulations

## Background

The following draft Income Tax Regulations concern the treatment of rapidly depreciating equipment and the ability of Canadian businesses to access new technology – two matters identified by the government in the December 1992 Economic and Fiscal Statement as representing areas in which the tax system could better contribute to the prosperity of Canadians in an increasingly competitive world economy.

In most cases, the capital cost allowance (CCA) system works well; it is relatively straightforward and provides, on average, cost recovery deductions for tax purposes that reflect the useful life of the property. Nevertheless, the rate at which any particular piece of equipment depreciates can vary significantly depending on how it is used and the progress of technological change. In this regard, consultations revealed that, in some circumstances, the CCA system does not adequately reflect variations in depreciation experience resulting from technological change. Certain types of property can become obsolete before being fully depreciated for income tax purposes. The most frequently identified types of property, for which such variation in depreciation was a concern, were computer equipment and certain types of office communication and electronic equipment.

Further, one of the important ways in which Canadian businesses access new technologies is by acquiring patents or rights to use patented information for new products or processes. Currently, patents and licences (rights) of a fixed period are written off on a straight-line basis over the life of the patent or licence. However, a patent's value often declines faster in its earlier years as new competing technologies are developed.

Therefore, on the basis of consultations with businesses to determine priorities and possible solutions in this regard, the budget includes two measures that concern the tax treatment of rapidly depreciating equipment and patents, or rights to use patented information. Details of these two measures in the form of draft regulations and explanatory notes are provided below.

## Draft Income Tax Regulations

1. (1) Paragraph 1100(1)(a) of the *Income Tax Regulations* is amended by deleting the word "and" at the end of subparagraph (xxviii) thereof, by adding the word "and" at the end of subparagraph (xxix) thereof and by adding thereto the following subparagraph:

"(xxx) of Class 44, 25 per cent,"

(2) Section 1100 of the said Regulations is further amended by adding thereto, immediately after subsection (9) thereof, the following subsection:

"(9.1) Where a part or all of the capital cost to a taxpayer of property that is a patent, or a right to use patented information, is determined by reference to the use of the property and that property is included in Class 44 in Schedule II, in lieu of the deduction allowed under paragraph (1)(a), there may be deducted in computing the taxpayer's income for a taxation year from a business or property, such amount as the taxpayer may claim in respect of the property not exceeding the lesser of

(a) the total of

(i) that part of the capital cost that is determined by reference to the use of the property in the year, and

(ii) the amount that would be deductible for the year by reason of paragraph (1)(a) in respect of the property of the class if the capital cost of the property did not include the amounts determined by reference to the use of the property in the year and preceding taxation years; and

(b) the undepreciated capital cost to the taxpayer as of the end of the taxation year (before making any deduction under this subsection for the taxation year) of property of the class."

2. Section 1101 of the said Regulations is amended by adding thereto, immediately following subsection (5o) thereof, the following subsection:

"(5p) A separate class is prescribed for one or more properties of a taxpayer included in Class 8 or Class 10 in Schedule II, each of which has a capital cost to the taxpayer of at least $1,000 and that is general-purpose electronic data processing equipment and systems software therefor, including ancillary data processing equipment, included in paragraph (f) of Class 10 in Schedule II, computer software, a photocopier or electronic communications equipment, such as a facsimile transmission device or telephone equipment, used by the taxpayer and in respect of which the taxpayer has (by letter attached to the return of income of the taxpayer filed with the Minister in accordance with section 150 of the Act for the taxation year in which the property or properties were acquired) elected that this subsection apply."

3. Section 1103 of the said Regulations is amended by adding thereto, immediately after subsection (2f) thereof, the following headings and subsections:

"Transfers to Class 8 or Class 10

(2g) For the purposes of this Part and Schedule II, where one or more properties of a taxpayer is included in a separate class pursuant to an election filed by the taxpayer in accordance with subsection 1101(5p), all such properties included in the separate class and owned by the taxpayer immediately after the beginning of the fifth taxation year beginning after the end of the taxation year in which the taxpayer was first eligible to claim capital cost allowance in respect of the property in the class, shall be transferred immediately after the beginning of the fifth taxation year from the separate class to the class in which the property would, but for the election, have been included.

Elections Not to Include Properties in Class 44

(2h) In respect of a property otherwise included in Class 44 in Schedule II, a taxpayer may, by letter attached to the taxpayer's return of income filed with the Minister in accordance with section 150 of the Act for the taxation year in which the property was acquired, elect not to include the property in Class 44 in Schedule II."

4. Class 14 in Schedule II to the said Regulations is amended by deleting the word “or” at the end of paragraph (c) thereof, by adding the word “or” at the end of paragraph (d) thereof and by adding thereto the following paragraph:

“(e) a property that is included in Class 44.”

5. Schedule II to the said Regulations is further amended by adding thereto the following class:

“Class 44

Property that is a patent, or a right to use patented information for a limited or unlimited period.”

6. Sections 1 to 5 apply to property acquired after April 26, 1993.

## *Explanatory notes on draft Income Tax Regulations*

ITR
1100(1)(a)(xxx)

Subsection 1100(1) of the *Income Tax Regulations* sets out the capital cost allowance (CCA) rates that taxpayers may claim with respect to specified classes of depreciable property.

Subsection 1100(1) is amended to provide a 25 per cent CCA rate for property described in new Class 44, that is a patent, or a right to use patented information for a limited or unlimited period. As is described in greater detail below, taxpayers acquiring Class 44 property may be eligible to claim CCA using an optional method in respect of property of the class if part of the capital cost of the property is dependent on the use of the property. Further, taxpayers will continue to be allowed the option of using the existing system that applies to a patent or right to use patented information.

This amendment applies to property acquired after April 26, 1993.

ITR
1100(9.1)

New subsection 1100(9.1) of the *Income Tax Regulations* provides an optional rule for computing CCA in respect of property placed in Class 44. This optional rule is provided in respect of property of a taxpayer that is a patent, or a right to use patented information for a limited or unlimited period, where all or a portion of the capital cost of the patent or right is dependent upon use. The capital cost of such property is required to be apportioned between the part dependent on use and the part, if any, not dependent on use. With respect to the part of the capital cost of the property that is dependent on use, CCA is determined with reference to that part of the capital cost that is dependent on use in the taxation year in which CCA is being claimed. In the case of the portion of the capital cost that is not dependent on use, CCA is to be computed using the 25 per cent CCA rate that applies to new Class 44, computed on a declining balance basis.

This amendment applies to property acquired after April 26, 1993.

ITR
1101

Section 1101 of the *Income Tax Regulations* provides separate classes in respect of certain property described in Schedule II to the Regulations.

New subsection 1101(5p) provides that taxpayers may elect to include one or more properties, included in Class 8 or Class 10 of Schedule II to the Regulations, each of which has a capital cost to the taxpayer of at least $1,000 and that is of a certain type and of the same class, in a separate class. The types of property upon which a taxpayer may file an election are:

- general-purpose electronic data processing equipment and systems software therefor, including ancillary data processing equipment, included in paragraph (f) of Class 10,
- computer software,
- a photocopier, and
- electronic communications equipment, such as a facsimile transmission device or telephone equipment (including related ancillary equipment).

Separate class elections are to be made by letter attached to the return of income of the taxpayer for the taxation year in which the property or properties were acquired by the taxpayer.

For example, and assuming that the capital cost of each separate property that is the subject matter of an election is at least $1,000, where a taxpayer acquires three photocopiers (Class 8 property) and one property that is general-purpose electronic data processing equipment, including ancillary data processing equipment (Class 10 property), the taxpayer may elect to place one, two or all three photocopiers in a separate Class 8. Similarly, the taxpayer may elect to place one photocopier in a separate class and the other two photocopiers in one or two other separate classes. Further, the taxpayer may elect to place the general-purpose electronic data processing equipment in a separate Class 10. Where a taxpayer does not elect to place property in a separate class, the property is to be included in the general class that otherwise applies to the particular property.

A special rule will require any property remaining in a separate class to be transferred, immediately after the beginning of the fifth taxation year beginning after the end of the taxation year in which the property was first available for use by the taxpayer for the purposes of claiming CCA deductions, to the class in which the property would, but for the election, have been included (see the commentary to new paragraph 1103(2g) of the Regulations in this regard).

This amendment applies to property acquired after April 26, 1993.

ITR
1103

Section 1103 of the *Income Tax Regulations* provides for elections to include property in and transfer property between classes in Schedule II to the Regulations. Section 1103 is amended in two respects.

First, new subsection 1103(2g) provides a special transfer rule where a taxpayer has elected under new subsection 1101(5p) to include one or more properties in a separate class (i.e. Class 8 or Class 10) and the property is owned by the taxpayer after the beginning of the fifth taxation year beginning after the end of the taxation year in which the property was first available for use by the taxpayer for the purposes of claiming capital cost allowance in respect of the property. In this regard, the property will be considered to be transferred immediately after the beginning of that fifth taxation year from the separate class to the class in which the property would, but for the election, have been included.

Second, new subsection 1103(2h) provides that taxpayers may elect not to include property that is a patent, or a right to use patented information, in Class 44. In such cases, the property will be, depending on whether it is for a limited or unlimited period, included in Class 14 or treated as eligible capital property. (Class 14 applies to, among other things, patents and licences for a limited period – the capital cost of which is, generally, written off on a straight-line basis over the life of the particular patent or licence.) Electing to treat a patent, or right to use patented information for a limited period, as being Class 14 property could be advantageous in cases where the patent or right is acquired late in the patent's life. Note: Canadian patents are issued by the government for a limited period.

These amendments apply to property acquired after April 26, 1993.

ITR
Schedule II – Class 14

Class 14 of Schedule II to the *Income Tax Regulations* generally applies to a patent, franchise, concession or licence for a limited period. Capital cost allowance in respect of such property is computed under paragraph 1100(1)(c) of the Regulations and, where applicable, under the optional method provided for in subsection 1100(9).

Class 14 is amended to preclude its application to property of a taxpayer that is a patent, or a right to use patented information for a limited period, and which is included in new Class 44. This amendment applies to property acquired after April 26, 1993.

ITR
Schedule II – Class 44

New Class 44 of Schedule II to the *Income Tax Regulations* applies to property that is a patent, or a right to use patented information for a limited or unlimited period. A taxpayer may elect under new subsection 1103(2h) not to include such property in new Class 44.

This amendment applies to property acquired after April 26, 1993.